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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1966.

No. 768

WILLIAM J. SULLIVAN AND
GEORGIA K. SULLIVAN,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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To The Honorable, The Chief Justice and The Associate Justices of The Supreme Court of The United States:

The petitioners, William J. Sullivan and Georgia K. Sullivan, by their counsel, pray that a Writ of Certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit.

OPINIONS BELOW

The opinion of the United States District Court entered June 29, 1965, is reported at 244 F. Supp. 605.

The opinion of the Court of Appeals for the Eighth Circuit entered August 3, 1966, is reported at 363 F. 2d 724.

The opinion of the District Court is reprinted in the appendix hereto (Appendix B, *infra*, p. A16). The opinion of the Court of Appeals for the Eighth Circuit is contained in the Record, p. 1.

JURISDICTION

The judgment of the Court below was entered on August 3, 1966 (R. 10). Upon a timely motion the Court below extended the time for filing a Petition for Rehearing to September 2, 1966. A timely Petition for Rehearing was denied on September 15, 1966 (R. 32). A timely Renewed Petition for Rehearing was denied on October 31, 1966 (R. 45).

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254.

QUESTIONS PRESENTED

1. Whether, when the corporation purchased the shares of stock of one of its shareholders (Nelson), and another shareholder (Sullivan) was bound by an executory contract to purchase at book value; has the corporation thereby distributed income as defined in the Sixteenth Amendment to Sullivan, where Sullivan admittedly received neither money nor property?

2. Whether, in a Federal tax case, the substance of the transaction is controlling, so that courts should consider motives, intent, and conduct in addition to written instruments.

3. Whether, since the subject transaction also constituted a partial liquidation of the corporation, there could be a dividend to petitioners by reason of Sections 346 (b) and 331, Internal Revenue Code of 1954.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Constitution of The United States, Sixteenth Amendment (Appendix A, *infra*, p. A1).

Constitution of The United States, Fifth Amendment (Appendix A, *infra*, p. A1).

Section 115, Internal Revenue Code of 1939.

Section 301[1] (Appendix A, *infra*, p. A2).

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Treasury Regulations, Internal Revenue Code of 1954:

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Sec. 1.346-2.

Rev. Rul. 58-614, C.B. 1958-2, p. 920.

Rev. Rul. 59-286, C.B. 1959-2, p. 103.

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1. Unless otherwise indicated, all references are to the Internal Revenue Code of 1954.

STATEMENT

This case originated with the filing of a complaint by petitioners, William J. and Georgia K. Sullivan[2] in the United States District Court for the Western District of Missouri (which had jurisdiction under Section 1346 (a) (1), Title 28 U.S.C.), to recover Federal income taxes and interest erroneously assessed and collected by the respondent (R. 1, 10).

The case was initiated by the District Director's determination that petitioner received a dividend by reason of a corporation's redemption of shares of stock from another shareholder (R. 84). An income tax assessment of $203,218.44, plus interest and costs, is in dispute (R. 85). The District Court dismissed petitioner's complaint with prejudice (Appendix C, *infra*, p. A51). Said judgment was affirmed by the Court of Appeals for the Eighth Circuit (Appendix C, *infra*, p. A52).

Sullivan was an automobile dealer with dealerships in Missouri and Kansas (R. 18, 19, 36). In 1941 Sullivan purchased a Chevrolet dealership in Blytheville, Arkansas, and organized a corporation to operate it, which is the corporation involved herein (R. 19, 85). The corporation issued a total of 300 shares of common stock, all that was ever issued (R. 86). The corporation hired a manager (Eich) in 1941 who served until 1948. During this period Eich purchased stock of the corporation from Sullivan, ultimately acquiring 120 shares (R. 20). By contract Sullivan was obligated to purchase Eich's stock if the latter's

2. Georgia K. Sullivan is involved only because a joint income tax return was filed; consequently, hereinafter references to "petitioner", the "taxpayer", or "Sullivan" apply only to William J. Sullivan.

employment by the corporation was terminated (R. 20). In February, 1948, Eich resigned his position with the corporation, Sullivan purchased his 120 shares of stock for $570.00 per share, and Sullivan became the owner of all the corporation's stock (R. 20, 86, 21, 26, 87). Sullivan did not want to be obligated to redeem another corporate manager's stock (R. 23).

In February, 1948 the corporation hired Nelson as manager to replace Eich, and Nelson was permitted to purchase some of the corporation's stock under a contract executed in September, 1948 by Nelson, the corporation, and Sullivan (R. 21, 47, 48, 57, 23, 49, 95, 99). Nelson signed the contract on September 10, 1948, and the corporation adopted and ratified the contract on that date (R. 23, 24, 25, 49, 50, 52). Sullivan signed the contract on September 14, 1948 (R. 24, 50, 95, 101).

The crucial provisions of the contract are: (1) Nelson was enabled to purchase up to 40 per cent of the corporation's stock, (2) Nelson could not mortgage, transfer, or sell his stock to anyone other than Sullivan or whomever Sullivan directed in writing, and (3) Sullivan agreed, within 30 days after an offer, to accept the offer to sell said shares of stock. By execution and adoption of the contract, the parties intended to provide for: (1) the sale by Sullivan to Nelson of part of the corporation's stock, and (2) the redemption by the corporation of Nelson's stock, if his employment by the corporation was terminated (R. 23, 24, 25, 26, 41, 42, 52, 53, 59, 60, 63, 64). The contract was executed to provide a manager for the corporation (R. 21, 47, 48, 95, 96, 99, 100). Nelson's right to buy and hold the stock depended upon his capacity to act as the corporation's manager (R. 99, 100).

Nelson paid $570.00 per share for the initial block of stock he purchased from Sullivan, which was the same

price Sullivan had paid Eich (R. 26, 27, 51). From February of 1948 through April, 1956, Nelson was the corporation's manager; and periodically purchased stock of the corporation from Sullivan until he ultimately owned 114 shares, about 38 per cent of the corporation's outstanding stock (R. 21, 47, 48, 109, 110, 111, 26, 27, 51, 87, 27).

In each year during the period 1948 through 1955, the corporation paid a cash dividend to its shareholders (R. 88).

Upon formation in 1941 the corporation was primarily engaged in the sale and servicing of new and used automobiles. By February of 1948, the corporation was also engaged in financing operations, and thereafter expanded this department of its business (R. 27, 155).

In late 1955, Nelson advised the corporation that he wanted to acquire his own automobile dealership, and in February of 1956 obtained an option to purchase a Chevrolet dealership located in another city (R. 27, 28, 53). The corporation's directors concluded that it was not possible to obtain a manager (to replace Nelson) acceptable to General Motors, with the necessary experience, and with sufficient capital to purchase Nelson's stock (R. 28, 29, 101, 102, 37, 38, 39, 40). Consequently, the directors decided to sell the operating assets of the automobile dealership to whoever received the Chevrolet franchise (from General Motors) in Blytheville, Arkansas; and continue the corporation only as a finance company (R. 101, 102, 29, 68, 69, 111). Sullivan directed in writing that Nelson offer his shares of stock to the corporation (R. 108).

In April, 1956, the corporation sold the operating assets of the automobile dealership, at book value, for cash in the approximate amount of $100,000.00; the corporation continued only as a finance company, and is in that business today (R. 32, 80, 81, 39, 33). The corporation accepted

Nelson's offer, and on May 1, 1956 paid Nelson $198,334.58 for his shares of stock which became treasury stock and has never been reissued (R. 88, 41-44, 68). Nelson's employment by the corporation was terminated (R. 55, 56). The per share book value of the corporation's stock—before and after the redemption—was the same, by reason of the corporation's payout to redeem Nelson's stock (R. 154).

The value of Sullivan's interest in the corporation was the same after the stock redemption and partial liquidation as before (R. 154; Ct. of Appeals Opinion, p. 8). Sullivan received no part of the payments made by the corporation in redemption of Nelson's stock (R. 55, 35, 154). At the time Nelson's stock was redeemed, no consideration was given to the tax effects of the transaction and there was no discussion pertaining to taxes (R. 61, 78). All of the documents at issue were executed either in 1948 or in 1956; about fifteen years and seven years, respectively, before this tax case arose in 1963 (R. 89-114, 85).

Though conceding that Sullivan received neither money or property, the Court below concluded he had received income (Ct. of Appeals Opinion, p. 8).

REASONS FOR GRANTING THE WRIT

I.

Though Sullivan Received No Income from the Transaction, the Court Below Has Imposed an Income Tax in Violation of the Sixteenth Amendment and of the Fifth Amendment.

There is no dispute that Nelson received the money and that Sullivan received neither money or property. Accordingly, the question is whether, when a corporation buys the shares of one of its stockholders, and another stock-

holder was by contract bound to buy at book value,[3] has the corporation thereby made a distribution of anything to the remaining stockholder?

This question, however, raises the complex and subtle question of what is income.

The Court below (Opinion, p. 8) concluded that the financial worth of Sullivan's interest in the corporation was the same after the transaction as it was before. Before the transaction, Nelson owned two-fifths of the corporation, worth about $200,000.00; and Sullivan owned three-fifths of the corporation, worth about $300,000.00. Upon the partial liquidation and stock redemption, the corporation paid Nelson about $200,000.00. Thus the value of Sullivan's interest in the corporation after the transaction remained $300,000.00. Concededly, thus far the transaction resulted in no economic benefit (or income) to Sullivan.

However, the Court below found (Opinion, p. 8) that the transaction resulted in an economic benefit to Sullivan because he was relieved of a *personal obligation* to purchase Nelson's stock. Conceding *arguendo* that Sullivan had a *personal obligation* to purchase Nelson's stock, the assumption thereof by the corporation cannot constitute income to Sullivan. Sullivan's obligation was to buy an asset for an amount equal to its value. Had he done so—had he purchased Nelson's shares of stock—he would have exchanged cash in the amount of $200,000.00 for an asset worth $200,000.00. His net worth would have remained the same—consequently, his "obligation" was not a liability or debt. For example, if Sullivan had been obligated to purchase General Motors stock worth $200,000.00, assigned that contract to the corporation, and the corpora-

3. Assumed arguendo.

tion purchased the stock; no one would contend that Sullivan received income. The aforesaid transaction is identical to the transaction at issue herein. The corporation's purchase of Nelson's stock did not increase Sullivan's wealth—or satisfy a debt or liability—accordingly, he received no income. We respectfully submit that the contrary conclusion of the Court below is erroneous and raises the Constitutional questions at issue herein.

Benefit is "a pecuniary advantage or profit; [or] gain; * * *." *Black's Law Dictionary*, Fourth Edition, p. 200. However, not all economic gain is taxable income. *Helvering* v. *Horst*, 311 U.S. 112, 115 (1940).

"Income" is income as the word is known in common speech. *United States* v. *Safety Car Heating & Lighting Co.*, 297 U.S. 88, 99 (1936). "Income" is gain derived from capital, from labor, or from both combined, including profit gained through the sale or exchange of capital. *Bowers* v. *Kerbaugh-Empire Co.*, 271 U.S. 170, 174 (1926). "Income" means an undeniable accession to wealth, clearly realized. *Commissioner of Internal Revenue* v. *Glenshaw Glass Company*, 348 U.S. 426, 431 (1955). The phrase "accession to wealth" plainly means an increase in financial worth. From this transaction, Sullivan received no gain or profit and no increase to his wealth—and the opinion of the Court below admits this. It follows that he received no income.

Most simply stated, conceding *arguendo* that the corporation satisfied an obligation of Sullivan, there was no income to him because the corporation did not satisfy a debt or liability of Sullivan. "Debt" or "liability" is used in the sense of an obligation for which the taxpayer has received something of value—something which *increased* his wealth. As above, if *Sullivan* had purchased the Gen-

eral Motors stock, which the corporation paid for, he would have received income—an "accession to wealth"—since his financial worth would have been increased. Moreover, if a taxpayer borrows money from a bank, executing a promissory note therefor, which his corporation satisfies, he has received income since his net worth has been increased (by a reduction of his liabilities). He received and retained the money—the corporation paid his debt. Income, however, arises from none of the foregoing analogies solely because of the satisfaction of a personal obligation—but because the personal obligation was accompanied by the receipt of money or property, or the satisfaction of an obligation for which money or property was received.

The touchstone of income is gain or profit, received in the form of money or property, which increases the taxpayer's wealth. The Court below has admitted that Sullivan received no gain, in the form of money or property, which increased his wealth.

If Sullivan had received income from this transaction, he should be able to pay the tax due from such income. Demonstrably, he cannot. Assume that Sullivan had only the personal contract obligation and owned three-fifths of the corporation, worth $300,000.00, but owned no other assets. Nelson, of course, received the $200,000.00 taxed to Sullivan. After the stock redemption, Sullivan has the same shares of stock worth the same amount as before. He has no money or property with which to pay the tax (about $150,000.00) he owes on the transaction. Admittedly, the Government can levy on Sullivan's stock and collect the $150,000.00—but this is a seizure of his capital investment.

The finale of this tax tragedy demonstrates the error in the conclusion of the Court below. After the redemp-

tion, Nelson has $200,000.00 on which he pays tax; and Sullivan has the same stock interest worth $300,000.00. The $200,000.00 received by Nelson is *also* taxed to Sullivan on which he owes $150,000.00 and the Government collects the tax from Sullivan's stock interest. Sullivan is now left with stock worth only $150,000.00. He has not received a nickel but has lost half of his capital investment. This cannot be the law.

It is undisputed that the only "income" in this case is the $200,000.00 Nelson received from the corporation in exchange for his stock. Nelson received $200,000.00 in cash and paid a capital gains tax thereon. Sullivan, however—who admittedly received neither money or property—has had the same $200,000.00 taxed to him. The only distinction is that Sullivan has been taxed at ordinary income rates. Obviously, only the Government received economic benefit from this transaction.

Income cannot be created from the mere satisfaction of an executory obligation. The satisfaction must be accompanied by or related to the receipt of money or property. Otherwise, there is no "accession to wealth". Without an increase in wealth, there is no income. *Commissioner of Internal Revenue* v. *Glenshaw Glass Company, supra.*

The conflict between the trial court's opinion in this case, and revenue rulings acquiescing in cases turning on the question of economic benefit, has been noted by authorities in the tax field, 24 N.Y.U. 1229, 1235, 1236 ("New York University Twenty-Fourth Annual Institute on Federal Taxation") (1966), as follows:

> "Distinction Between Executory and Executed Contracts
>
> * * *

The acquiescences may be construed as reflecting the Service's position that a constructive dividend would not ensue from a corporation's performance of a shareholder's wholly executory contractual obligation to purchase the stock of another shareholder, provided that the purchase price was geared to fair market value."

(1235)

"Economic Benefit Theory

* * *

"Then along came the recent decision in Sullivan v. United States,[16] which rejected the very arguments (by the taxpayer) which the Service's prior acquiescences seemed to approve. The court refused to perceive any valid distinction between the discharge of a shareholder's debt and the performance of his executory contractual obligation. Moreover, the economic benefit to the shareholder was viewed not in the sense of net worth or the value of his interest in the corporation but quite literally as follows: 'The economic benefit to the plaintiff Sullivan in this case was the discharge by the corporation of his private obligation to purchase Nelson's stock with the use of corporate earnings.'

"The *Sullivan* case could make some interesting waves. If the Service intends to adhere to the position apparently signaled by its acquiescences to *Kobacker* and *Decker* it ought to do so clearly and affirmatively."

(1236)

The conclusion of the Court below that Sullivan received income is in square conflict with one of its prior decisions, with the decisions of other Courts of Appeal, with the decisions of the Tax Court of the United States, and with the Commissioner's own rulings on this question. In *Ruben* v. *Commissioner of Internal Revenue*, 97 F. 2d 926, 928 (C.C.A. 8th, 1938), the corporation of which Ruben

was a shareholder paid a compromised judgment binding upon the corporation and certain shareholders, including Ruben. There the Court recognized that the corporation had reduced its net worth by payment of the judgment, and that Ruben had received nothing since he received no economic benefit—even though he had been released from a *personal judgment* against him. In *Ruben*, the Court specifically found that there were no gains, profits, or "income" to the taxpayer.

The determination of the Court below that Sullivan received income is in square conflict, upon identical facts with *John A. Decker*, 32 T.C. 326 (1959), aff'd 286 F. 2d 427 (C.A. 6th, 1960). In *Decker* there was no dispute that the taxpayer was *unconditionally obligated* to purchase the stock and that the obligation was assumed by the corporation. The Tax Court, however, specifically found that the taxpayer received no income because he received no economic benefit from the transaction, stating that (p. 333):

> "While petitioners may have been *obligated* to purchase the stock of a deceased stockholder, this is a different sort of obligation from those in the *Wall*, *Ferro*, and other cases wherein this point has been raised. Petitioners' obligation here was to purchase stock for its book value. Presumably the stock was worth what was paid for it. Had petitioners bought and retained the stock, their net worths would have remained the same. The corporation did not pay a pre-existing *debt* of the petitioners, the satisfaction of which would increase their net worths. They realized no economic benefit from the transaction." (Emphasis added).

The determination of the Court below that Sullivan received income from this transaction is also in conflict with the substance of the decisions of other Courts of Appeals on this question. *Schmitt* v. *Commissioner of*

Internal Revenue, 208 F. 2d 819, 821 (C.A. 3rd, 1954); *Holsey* v. *Commissioner of Internal Revenue*, 258 F. 2d 865, 868 (C.A. 3rd, 1958); *Niederkrome* v. *C. I. R.*, 266 F. 2d 238, 243 (C.A. 9th, 1958). In *Holsey*, the Court stated that whatever benefits the majority stockholder enjoyed through acquisition by the corporation of the shares of another shareholder "could not give rise to taxable income within the meaning of the Sixteenth Amendment * * *". In *Niederkrome* the Court held that the "real question is whether the taxpayers received any financial or economic benefits as a result of the redemption * * *".

The Tax Court regularly determines that no dividend was received where the taxpayer's financial worth was not increased—even though the redeeming corporation discharged an unconditional contract obligation of the surviving shareholder to redeem another shareholder's stock. *John A. Decker, supra*, p. 333; *William A. Green*, T. C. Memo. 1963-248, 22 T.C.M. 1241, 1246 (1963); *John McShain*, T. C. Memo. 1963-306, 22 T.C.M. 1611, 1616 (1963); *Accord, William K. Edmister*, 46 T.C. ....., No. 67 (1966) (Where the distinction between cases resulting in income, and those wherein the taxpayers in reality received nothing, is clearly pointed out).

The Commissioner of Internal Revenue has ruled that there can be no constructive dividend unless the stock is in reality *purchased* by a remaining shareholder and paid for by the corporation—even though the corporation's redemption of stock relieved the remaining shareholder of a *personal obligation* to redeem said stock. Rev. Rul. 58-614, C.B. 1958-2, p. 920; Rev. Rul. 59-286, C.B. 1959-2, pp. 103, 105 (Appendix A, *infra*, p. A11). At page 2 of its Opinion the Court below determined that the *corporation* purchased the stock. Consequently, the Court's conclusion herein is in square conflict with the respondent's announced litigating position on this question. In support of the con-

clusion that Sullivan received income, the Court below relied on three cases cited on page 7 of its Opinion. None of said cases are relevant as demonstrated on pages 10 and 11 of Appellants' Petition for Rehearing. The Court below also relied extensively on *Idol* v. *C. I. R.*, 319 F. 2d 647 (C.A. 8th, 1963). That case is clearly distinguishable as urged on page 4 of Appellants' Renewed Petition for Rehearing. In each of the aforementioned cases, the taxpayer obviously received money or property—or the corporation satisfied a debt of the taxpayer for which money or property had been received. Accordingly, the conclusion of the Court below that Sullivan received income is unsupported by relevant case law.

This issue has been a prolific source of litigation for at least twenty years—literally scores of cases involving this question have been before the Courts. Those cases, however, do not include one—where a taxpayer received nothing more than the satisfaction of a personal obligation —wherein a Court concluded that the taxpayer received income. Even the Commissioner of Internal Revenue has ruled that "there is no authority affirmatively supporting the proposition that a redemption of one shareholder's shares, at fair market value, constitutes a dividend to the remaining shareholder". Rev. Rul. 59-286, *supra*, p. 105.

The conclusion of the Court below that petitioners received income is in direct conflict with the decisions of this Court construing the meaning of income within the Sixteenth Amendment. *Eisner* v. *Macomber*, 252 U.S. 189, 206, 207 (1920); *Edwards* v. *Cuba R. Co.*, 268 U.S. 628, 631 (1925); *U.S.* v. *Safety Car Heating & Lighting Co., supra; Bowers* v. *Kerbaugh-Empire Co., supra; Commissioner of Internal Revenue* v. *Glenshaw Glass Company, supra.*

Since petitioners received no income, to impose a tax is in violation of the Sixteenth Amendment; and is also in

violation of the Fifth Amendment, since they have been deprived of their property without due process of law.

II.

In a Federal Tax Case the Substance and Reality of the Transaction Is Controlling, the Courts Should Consider Motives, Intent, and Conduct in Addition to Written Instruments; Consequently, the Decision of the Court Below Admittedly Exalting Form Over Substance Is in Conflict with the Decisions of This Court and with the Decisions of Other Courts of Appeals.

On trial, five witnesses testified, without contradiction, on behalf of petitioners. This testimony was supported by substantial documentary evidence, which had been executed many years prior to the initiation of this case. The aforesaid evidence established that when the contract was executed in September, 1948, the parties intended that the corporation would be obligated to redeem Nelson's stock (by reason of its ratification and adoption of the contract); and that it was never intended that Sullivan would be personally obligated to redeem said stock. The trial court adopted the findings of fact set forth in petitioners' briefs practically verbatim and concluded that the oral evidence supported petitioners' factual contentions—but could not be considered because of the parol evidence rule. *Sullivan* v. *United States*, 244 F. Supp. 605, 615 (D.C. Mo., 1965) (Appendix B, *infra*, p. A16).

The substance of the transaction is clear. If Nelson left the corporation, the contract provided Sullivan the right to direct the sale of Nelson's stock to the manager who replaced him. Since Nelson could not be replaced, the corporation liquidated the automobile dealership, continued as a finance company, and redeemed Nelson's stock. The contract gave Sullivan an option—buy the stock, or direct its sale to a third party. Here the third party was

the corporation—thus this transaction is identical to that in *Holsey* v. *Commissioner of Internal Revenue, supra,* pp. 866, 868; *S. K. Ames, Inc.,* 46 B.T.A. 1020, 1023-1024 (1942) (Acq., C.B. 1942-1, p. 1); *Fred F. Fischer,* Memo. Op., Docket No. 8737, 6 T.C.M. 520, 525 (1947); *Benjamin H. Freeman,* 41 T.C. 379, 384 (1963). The Commissioner of Internal Revenue has followed *Holsey* and *Ames* in ruling that where the contract obligation was an option, or was conditional—no dividend resulted from its assumption by the corporation. Rev. Rul. 59-286, *supra,* p. 105. In the Court below the Government admitted on brief that the contract obligation herein was conditional (Appellee's Brief, pp. 16, 23).

On page 9 of its Opinion, the Court of Appeals herein recognized that its determination exalted form over substance. In tax cases, the substance and reality of the transaction is controlling, formal written documents are not rigidly binding, and Courts should consider motives, intent, and conduct in addition to written instruments. *United States* v. *Phellis,* 257 U.S. 156, 168 (1921); *Weiss* v. *Stearn,* 265 U.S. 242, 254 (1924); *Bowers* v. *Kerbaugh-Empire Co., supra,* p. 174; *Helvering* v. *F. & R. Lazarus & Co.,* 308 U.S. 252, 255 (1939); *Commissioner of Internal Revenue* v. *Court Holding Co.,* 324 U.S. 881, 884 (1945); *United States* v. *Cumberland Public Service Co.,* 338 U.S. 451, 454, fn. 3 (1950); *C. I. R.* v. *Hansen,* 360 U.S. 446, 461 (1959). Consequently, the decision of the Court below is in square conflict with the decisions of this Court on this principle.

On this principle, the decision of the Court below is also in square conflict with its holdings in other cases. *Helvering* v. *Killian Co.,* 128 F. 2d 433, 434 (C.C.A. 8th, 1942); *Boykin* v. *Commissioner of Internal Revenue,* 260 F. 2d 249, 254 (C.A. 8th, 1958); *Western Contracting Corporation* v. *C. I. R.,* 271 F. 2d 694, 699 (C.A. 8th, 1959).

Moreover, the determination of the Court below on this question is in square conflict with the decisions of other Courts of Appeals. *Fox* v. *Harrison*, 145 F. 2d 521, 522 (C.C.A. 7th, 1944); *Landa* v. *Commissioner of Internal Revenue*, 206 F. 2d 431, 432 (C.A., D.C., 1953); *Lacy* v. *C. I. R.*, 341 F. 2d 54, 57 (C.A. 10th, 1965) (Where the Court stated that "Although the ambiguity of the contract may be arguable, we are convinced that parol testimony was admissible to explain the intent and motives of the parties. In no other way may substance be separated from form"); *R. C. Owen Company* v. *C. I. R.*, 351 F. 2d 410, 414 (C.A. 6th, 1965); *Foxman* v. *C. I. R.*, 352 F. 2d 466, 469 (C.A. 3rd, 1965); *Kinney* v. *United States*, 358 F. 2d 738, 739 (C.A. 5th, 1966); *Blueberry Land Company* v. *C. I. R.*, 361 F. 2d 93, 101 (C.A. 5th, 1966).

The determination of the Court below is in square conflict with the rule followed by the Court of Claims. *Affiliated Research, Inc.* v. *United States*, 351 F. 2d 646, 648 (Ct. Clms., 1965).

The decision of the Court below is also in square conflict with decisions of the Tax Court extending over at least a twenty-year period. *Charles F. Mitchell*, 45 B.T.A. 300, 303 (1941); *Penn Athletic Club Building*, 10 T.C. 919, 939 (1948); *Sarah Helen Harrison*, 17 T.C. 1350, 1357 (1952); *Rupe Investment Corporation*, 30 T.C. 240, 251 (1958); *Estate of Leon Holtz*, 38 T.C. 37, 41 (1962); *Walter Lacy*, 39 T.C. 1100, 1104 (1963).

The error of the Courts below on the question of substance versus form was compelled by their erroneous conclusion on the parol evidence rule. Only Sullivan, Nelson, and the corporation were parties to the contract. The respondent was not a party to the contract, or in privity with a party thereto. The parol evidence rule cannot be

invoked by the respondent herein because the principle is clear that the parol evidence rule cannot be invoked either by or against a stranger to the contract. *Miller* v. *Robertson*, 266 U.S. 243, 255 (1924); *Birmingham* v. *Bartels*, 157 F. 2d 295, 301 (C.C.A. 8th, 1946), rev'd other grounds, 332 U.S. 126 (1947); *Reynolds* v. *Boos*, 188 F. 2d 322, 324 (C.A. 8th, 1951); *Johnson Farm Equipment Company* v. *Cook*, 230 F. 2d 119, 125 (C.A. 8th, 1956). The conclusion of both Courts below to the contrary is in square conflict with the decisions of this Court and with the decisions of the Court of Appeals for the Eighth Circuit. In *Birmingham* v. *Bartels*, this Court's reversal of the Eighth Circuit left this Court's determination supported solely by the parol evidence admitted in the trial court. In *Reynolds* v. *Boos* the Court below analyzed the Supreme Court's opinion in *Birmingham* v. *Bartels* and concluded that the Supreme Court's determination therein supported its admission of parol evidence in a tax case where the Government was not a party to the disputed agreement. However, the Court below did not follow, overrule, or distinguish its own prior decisions on this question—which plainly support petitioners.

The principle that a stranger to the contract may not invoke the parol evidence rule is followed by virtually every United States Court of Appeals. *Stern* v. *Commissioner*, 137 F. 2d 43, 46 (C.C.A. 2nd, 1943); *Brassert* v. *Clark*, 162 F. 2d 967, 973 (C.C.A. 2nd, 1947); *Commissioner of Int. Rev.* v. *Penn Athletic Club Building*, 176 F. 2d 939, 944 (C.A. 3rd, 1949); *Patterson* v. *Texas Co.*, 131 F. 2d 998, 1001 (C.C.A. 5th, 1943); *Scofield* v. *Greer*, 185 F. 2d 551, 552 (C.A. 5th, 1950); *Scott* v. *Gearner*, 197 F. 2d 93, 96 (C.A. 5th, 1952); *Commissioner of Internal Revenue* v. *Gibbs-Preyer Trust Nos. 1 and 2*, 117 F. 2d 619, 622 (C.C.A. 6th, 1941); *Borin Corporation* v. *Commissioner of*

Internal Revenue, 117 F. 2d 917, 920 (C.C.A. 6th, 1941), cert. den. 314 U.S. 638; *Essington* v. *Parish*, 164 F. 2d 725, 729 (C.C.A. 7th, 1947); *Thorsness* v. *United States*, 260 F. 2d 341, 345 (C.A. 7th, 1958); *Worcester Felt Pad Corp.* v. *Tucson Airport Authority*, 233 F. 2d 44, 51 (C.A. 9th, 1956); *Smith* v. *C. I. R.*, 324 F. 2d 725, 726 (C.A. 9th, 1963); *American Crystal Sugar Co.* v. *Nicholas*, 124 F. 2d 477, 479 (C.C.A. 10th, 1941); *Bardwell* v. *C. I. R.*, 318 F. 2d 786, 790 (C.A. 10th, 1963); *Landa* v. *Commissioner of Internal Revenue, supra*, p. 432; *Gibson* v. *United States*, 268 F. 2d 586, 589 (C.A., D.C., 1959). This principle is also followed by the Court of Claims. *Mustard* v. *United States*, 155 F. Supp. 325, 332 (Ct. Clms., 1957). Since most of the cases cited are Federal tax cases, the rule is universally followed in tax cases involving either the United States or the Commissioner of Internal Revenue as a party. The holding of the Court below on this question is in square conflict with the aforesaid decisions of the Courts of Appeals and the Court of Claims.

The Tax Court of the United States (formerly the Board of Tax Appeals), has followed the foregoing principle since its creation in 1925, through the intervening years up to the present time. *Converse & Co.*, 1 B.T.A. 742, 745 (1925); *J. W. Solof*, 1 B.T.A. 776, 785 (1925); *Arthur B. Grover*, 3 B.T.A. 508, 513 (1926); *The Amalgamated Sugar Co.*, 4 B.T.A. 568, 575 (1926); *Stratton Grocery Co.*, 8 B.T.A. 317, 322 (1927); *James D. Boone*, 27 B.T.A. 1064, 1067 (1933); *United National Corporation*, 33 B.T.A. 790, 798 (1935); *Macon, Dublin & Savannah Railroad Co.*, 40 B.T.A. 1266, 1271 (1939); *Combs Lumber Co.*, 41 B.T.A. 339, 342 (1940); *Charles F. Mitchell, supra*, p. 303; *Haverty Realty & Investment Co.*, 3 T.C. 161, 167 (1944); *Penn Athletic Club Building, supra*, p. 938; *Sarah Helen Harrison, supra*, p. 1357; *Estate of Leon Holtz, supra*,

p. 41; *Elizabeth H. Bardwell*, 38 T.C. 84, 90 (Fn. 2) (1962); *Walter Lacy, supra*, p. 1104; *Clifford H. Wren*, T.C. Memo. 1965-52, 24 T.C.M. 290, 294 (1965). The Tax Court, which is concerned almost entirely with cases involving Federal taxation, has universally applied this majority rule. Research has failed to disclose a single Tax Court case to the contrary.

Our system of income taxation is national in scope, and contemplates the uniform treatment of taxpayers. No citizen should be required to bear more than his share of the burden, or sustain a litigating loss, by reason of a radical departure from the prevailing view on an evidence question. Precisely that result, however, has been reached in the Court below. A tax exceeding $200,000.00 (including interest and costs), has been adjudged against petitioners solely because of the Court's ruling on the parol evidence question. The facts are undisputed. As stated above, the trial court conceded that the oral evidence supports the factual contentions of petitioners—but accorded that evidence no legal effect because of its holding on the parol evidence question.

The Court's holding on this principle will have a far-reaching effect on tax litigation throughout the Nation. Accordingly, the lower Courts and tax litigants must be apprised of which principle prevails—*Sullivan* v. *United States* or the decisions of this Court, prior decisions of the Eighth Circuit, the decisions of the other Courts of Appeals, of the Court of Claims, and the Tax Court.

The taxpayer, as well as the Government, is entitled to the benefit of the substance versus form rule. *C.I.R.* v. *Hansen, supra*, p. 461; *Landa* v. *Commissioner of Internal Revenue, supra*, p. 432. Accordingly, the Court's holding on the parol evidence question is of no lasting

comfort to the Government. If this rule bars a taxpayer from establishing the substance and reality of a transaction—it also bars the Government. Consequently, henceforth, taxation will turn on mere form, and any artificial and contrived sham will control—so long as it is reflected in a written document. If the conclusion of the Court below on this question is permitted to stand, reality will be lost to the administration of the Revenue Laws. Fiction will prevail.

III.

Since the Subject Transaction Also Constituted a Partial Liquidation of the Corporation, There Could Not Be a Dividend to Sullivan by Reason of the Explicit Provisions of Sections 346 (b) and 331; Consequently, the Refusal of the Court Below to Pass on This Issue So Departs from the Accepted Course of Judicial Proceedings As to Require This Court's Supervision.

In each of the Courts below petitioners urged that, by reason of Congressional intent in enacting the foregoing statutes, and the literal language thereof, there could not be a dividend to Sullivan. At least the trial court passed on this question—holding that Section 346 was not intended to apply to a situation such as is involved here. *Sullivan* v. *United States, supra,* p. 624. (As will be seen hereinafter, however, this conclusion is in square conflict with the opinion of the Court of Appeals for the Eighth Circuit in *United States* v. *Carey,* 289 F. 2d 531, 536 (C.A. 8th, 1961).)

Though argued on principal and reply brief by petitioners in the Court of Appeals, and urged on the original and renewed Petitions for Rehearing, the Opinion of the Court below contains no reference whatsoever to this issue. The failure of the Court of Appeals to pass on this question is aggravated by its recognition in *Carey* that this question

was relevant to the issue of a constructive dividend, and by the Court's construction of Section 346 in *Carey* which plainly supports petitioners herein.

There is no dispute on the facts which satisfy the objective requirements of Section 346 (b). The redemption was attributable to Nelson's resignation and the corporation's ceasing to conduct the Chevrolet business (R. 101, 102, 172, 173, 39). The Chevrolet business had been conducted for the five-year period immediately before the distribution, since it was incorporated soon after Sullivan acquired the dealership in 1941 (R. 19, 85). The finance business had also been conducted for more than five years since expansion of that department was commenced in the latter part of 1948 (R. 27). After the distribution the corporation continued in the finance business and was so engaged at the time of trial (R. 33). Finally, since the finance business was initiated sometime prior to 1948, it was not acquired by the corporation within the five-year period preceding the distribution in a transaction in which gain or loss was recognized (R. 27). Thus each of the objective requirements of Section 346 (b) are met—clearly, there was a termination of a business and a contraction of the corporation which constitutes a partial liquidation under Section 346 (b).

Under Section 115 of the 1939 Code, the only criteria was whether the transaction was "essentially equivalent to a dividend". In viewing a transaction involving this question from the shareholder level and the corporate level, the courts struggled with this one concept for years.[4] Over the years the courts developed two overriding criteria in

4. Discussions of this historical confusion and Congressional attempts to eliminate it by enactment of the 1954 Code appear in: 10 Tax Law Review 213 (1954), and 103 Pennsylvania Law Review 936 (1955).

determining whether there was dividend equivalency under Section 115. The first test, applied at the shareholder level, was whether there had been a termination or significant reduction in the interest of the stockholder in the corporation. The second test, which viewed the transaction from the corporate level, was whether there had been a contraction or partial liquidation of the corporation. *United States* v. *Carey, supra,* p. 534; *Sorem* v. *C. I. R.,* 334 F. 2d 275, 279-280 (C.A. 10th, 1964).[5] Congress recognized these two criteria in the enactment of the 1954 Code. Congress incorporated the first concept in Section 302 of the 1954 Code; and the second in Section 346 of the 1954 Code. Congress intentionally segregated the two concepts under separate provisions of the Code in order to sharpen the distinction between them. *United States* v. *Carey, supra,* p. 535; *McCarthy* v. *Conley,* 341 F. 2d 948, 951 (C.A. 2nd, 1965); The Law of Federal Income Taxation (Mertens), Vol. I (Zimet Ed.), Sec. 9.70, p. 134; Code Commentary (Mertens), Section 346, p. 178.

Moreover, in Section 346 (b), Congress went a step further. If a transaction constitutes a partial liquidation under Subsection (b) of Section 346 the question of dividend equivalency is not applicable. In other words, transactions falling within the provisions of Section 346 (b) are *by statute* "not essentially equivalent to a dividend". Section 346 (b); S. Rep. No. 1622, 83rd Cong., 2nd Sess., 3 U.S. Code Cong. and Adm. News (1954), p. 4900; *United States* v. *Carey, supra,* p. 536; *McCarthy* v. *Conley, supra,* p. 955. In *Carey* the Court below specifically held that "Subsection 346 (b) sets out a specific type of distribution

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5. In the case at bar, the transaction satisfied both criteria —all of Nelson's stock was redeemed; and there was a contraction and partial liquidation of the corporation. Thus, even under the 1939 Code and the case law based thereon, there was no constructive dividend to Sullivan. *Sorem* v. *C. I. R., supra,* p. 279.

involving the termination of a business activity conducted for five years which will constitute a liquidation *not equivalent to a dividend*"[6] (Emphasis added). However, in *Carey*, since the Court below affirmed the trial court's holding that the stock redemption was not essentially equivalent to a dividend under Section 302, the Court concluded (Opinion, p. 536), that it was unnecessary to determine the question of what constitutes a partial liquidation under Section 346. The question was moot in *Carey*. Obviously, it is not moot in this case.

Petitioners submit that in *Carey* the Court below specifically recognized the applicability of Section 346 to the question of dividend equivalency—the only issue in that case. On the authority of *Carey*, petitioners respectfully contend that the Court below should have ruled on the effect of Section 346 (b) on the dividend issue herein. The substance of the transaction at issue in *Carey* and in the instant case is the same: a corporation redeemed the shares of a departing shareholder and the remaining shareholder was charged with the receipt of a dividend. In *Carey*, though the remaining shareholder received property from the corporation, the Court below concluded he received a capital gain. In the case at bar, though Sullivan admittedly received neither money or property—the same Court concluded he received ordinary income. Obviously, Congress did not intend such results.

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6. This result follows because of the statutory arrangement of Section 346 (a) and (b). Section 346 (a) (2) contains the phrase "not essentially equivalent to a dividend"—consequently a transaction under Section 346 (a) (2) must meet this test. This test, however, is not contained in Section 346 (b). To the contrary, Section 346 (b) plainly states that if a transaction falls under its provisions, "a distribution shall be treated as a *distribution described* in Subsection (a) (2)" (Emphasis added). The distribution "described" in Section 346 (a) (2) is one "not essentially equivalent to a dividend".

Finally, since distributions under Section 346 are governed by Section 331, and the latter section (and the regulations under that Section (Appendix A, *infra*, p. A11) specifically hold that Section 301 (governing dividend distributions), is not applicable—there can be no dividend to anyone in the instant case. Moreover, if a distribution (as here) falls within both Sections 302 and 346, only the latter provision is applicable. Section 346 (c); Regulations Sec. 1.346-2; Code Commentary (Mertens), Section 346 (c): 1, p. 183.

At page 6 of its Opinion the Court below—in stating the basic questions at issue in this case—relied on both Sections 301 and 302 of the 1954 Code. Since the subject stock redemption also constitutes a partial liquidation under Section 346 (b)—as a matter of law—neither Section 301 nor 302 is applicable. (As contended above, this is the precise result Congress intended by enactment of Section 302 and Section 346.) Accordingly, the determination of the Court below is without statutory support.

The question presented is solely a question of law, and is dispositive of the only issue in this case. Again, in *Carey*, the Court below specifically recognized the applicability of Section 346 (b) to the constructive dividend question—the only issue herein. Furthermore, though repeatedly brought to its attention, the Court below refused to pass on this question.

The Court's refusal to decide this question constitutes a radical departure from the accepted course of judicial proceedings which requires this Court's supervision.

If the determination of the Court below is allowed to stand a rank injustice will have been done to petitioners. Moreover, the intent of Congress in enacting the subject statutes (to eliminate confusion) will have been completely

frustrated. The law will remain as confused as it has been for forty years.[7]

IV.

Conclusion.

For the reason stated, it is respectfully submitted that this Petition for Certiorari should be granted.

Respectfully submitted,

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7. Legal periodicals invariably stress the confusion in this area of the tax law, e.g.:

"The Dividend Equivalence Test: Forty Years of Confusion," 43 Texas Law Review 755 (No. 5), (April 1965).

Murphy, "Dividend Equivalency—the End of the Beginning," 10 Tax Law Review 213 (1954). The first sentence reads: "Nowhere in the field of federal income taxation has there been an area so rife with confusion or so ripe for reform as that surrounding Section 115 (g) of the 1939 Code."

Eustice, "Cancellation of Indebtedness and the Federal Income Tax: A Problem of Creeping Confusion," 14 Tax Law Review 225 (1959).

Schlossberg, "Confusion Between Partial Liquidations and Redemptions Often Clouds Tax Planning," 22 The Journal of Taxation 152 (March 1965).

APPENDIX A

Constitutional and Statutory Provisions Involved

Constitution of the United States:

AMENDMENT XVI.

The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

AMENDMENT V.

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

Internal Revenue Code of 1939:

[Sec. 115(g)]

(g) REDEMPTION OF STOCK.—

(1) IN GENERAL.—If a corporation cancels or redeems its stock (whether or not such stock was issued as a stock dividend) at such time and in such manner as to make the distribution and cancellation or redemption in whole or in part essentially equivalent to the distribution of a

taxable dividend, the amount so distributed in redemption or cancellation of the stock, to the extent that it represents a distribution of earnings or profits accumulated after February 28, 1913, shall be treated as a taxable dividend.

[Sec. 115(i)]

(i) DEFINITION OF PARTIAL LIQUIDATION.—As used in this section the term "amounts distributed in partial liquidation" means a distribution by a corporation in complete cancellation or redemption of a part of its stock, or one of a series of distributions in complete cancellation or redemption of all or a portion of its stock.

Internal Revenue Code of 1954:

Sec. 301. DISTRIBUTIONS OF PROPERTY.

(a) IN GENERAL.—Except as otherwise provided in this chapter, a distribution of property (as defined in section 317 (a)) made by a corporation to a shareholder with respect to its stock shall be treated in the manner provided in subsection (c).

* * *

(c) AMOUNT TAXABLE.—In the case of a distribution to which subsection (a) applies—

(1) AMOUNT CONSTITUTING DIVIDEND.—That portion of the distribution which is a dividend (as defined in section 316) shall be included in gross income.

* * *

Sec. 302. DISTRIBUTIONS IN REDEMPTION OF STOCK.

(a) GENERAL RULE.—If a corporation redeems its stock (within the meaning of section 317(b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such

redemption shall be treated as a distribution in part or full payment in exchange for the stock.

(b) REDEMPTIONS TREATED AS EXCHANGES.—

(1) REDEMPTIONS NOT EQUIVALENT TO DIVIDENDS.—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

(2) SUBSTANTIALLY DISPROPORTIONATE REDEMPTION OF STOCK.—

(A) IN GENERAL.—Subsection (a) shall apply if the distribution is substantially disproportionate with respect to the shareholder.

(B) LIMITATION.—This paragraph shall not apply unless immediately after the redemption the shareholder owns less than 50 percent of the total combined voting power of all classes of stock entitled to vote.

(C) DEFINITIONS.—For purposes of this paragraph, the distribution is substantially disproportionate if—

(i) the ratio which the voting stock of the corporation owned by the shareholder immediately after the redemption bears to all of the voting stock of the corporation at such time,

is less than 80 percent of—

(ii) the ratio which the voting stock of the corporation owned by the shareholder immediately before the redemption bears to all of the voting stock of the corporation at such time.

For purposes of this paragraph, no distribution shall be treated as substantially disproportionate unless the shareholder's ownership of the common stock of the corporation (whether voting or nonvoting) after and before redemption also meets the 80 percent requirement of the preceding sentence. For purposes of the

preceding sentence, if there is more than one class of common stock, the determinations shall be made by reference to fair market value.

(D) SERIES OF REDEMPTIONS.—This paragraph shall not apply to any redemption made pursuant to a plan the purpose or effect of which is a series of redemptions resulting in a distribution which (in the aggregate) is not substantially disproportionate with respect to the shareholder.

(3) TERMINATION OF SHAREHOLDER'S INTEREST.—Subsection (a) shall apply if the redemption is in complete redemption of all of the stock of the corporation owned by the shareeholder.

(4) STOCK ISSUED BY RAILROAD CORPORATIONS IN CERTAIN REORGANIZATIONS.—Subsection (a) shall apply if the redemption is of stock issued by a railroad corporation (as defined in section 77 (m) of the Bankruptcy Act, as amended) pursuant to a plan of reorganization under section 77 of the Bankruptcy Act.

(5) APPLICATION OF PARAGRAPH.—In determining whether a redemption meets the requirements of paragraph (1), the fact that such redemption fails to meet the requirements of paragraph (2), (3), or (4) shall not be taken into account. If a redemption meets the requirements of paragraph (3) and also the requirements of paragraph (1), (2), or (4), then so much of subsection (c) (2) as would (but for this sentence) apply in respect of the acquisition of an interest in the corporation within the 10-year period beginning on the date of the distribution shall not apply.

* * *

Sec. 316. DIVIDEND DEFINED.

(a) GENERAL RULE.—For purposes of this subtitle, the term "dividend" means any distribution of property made by a corporation to its shareholders—

(1) out of its earnings and profits accumulated after February 28, 1913, or

(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made.

Except as otherwise provided in this subtitle, every distribution is made out of earnings and profits to the extent thereof, and from the most recently accumulated earnings and profits. To the extent that any distribution is, under any provision of this subchapter, treated as a distribution of property to which section 301 applies, such distribution shall be treated as a distribution of property for purposes of this subsection.

* * *

Sec. 317. OTHER DEFINITIONS.

(a) PROPERTY.—For purposes of this part, the term "property" means money, securities, and any other property; except that such term does not include stock in the corporation making the distribution (or rights to acquire such stock).

(b) REDEMPTION OF STOCK.—For purposes of this part, stock shall be treated as redeemed by a corporation if the corporation acquires its stock from a shareholder in exchange for property, whether or not the stock so acquired is cancelled, retired, or held as treasury stock.

Sec. 331. GAIN OR LOSS TO SHAREHOLDERS IN CORPORATE LIQUIDATIONS.

(a) GENERAL RULE.—

(1) COMPLETE LIQUIDATIONS.—Amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock.

(2) PARTIAL LIQUIDATIONS.—Amounts distributed in partial liquidation of a corporation (as defined in section 346) shall be treated as in part or full payment in exchange for the stock.

(b) NONAPPLICATION OF SECTION 301.—Section 301 (relating to effects on shareholder of distributions of property) shall not apply to any distribution of property (other than a distribution referred to in paragraph (2) (B) of section 316(b)), in partial or complete liquidation.

Sec. 346. PARTIAL LIQUIDATION DEFINED.

(a) IN GENERAL.—For purposes of this subchapter, a distribution shall be treated as in partial liquidation of a corporation if—

(1) the distribution is one of a series of distributions in redemption of all of the stock of the corporation pursuant to a plan; or

(2) the distribution is not essentially equivalent to a dividend, is in redemption of a part of the stock of the corporation pursuant to a plan, and occurs within the taxable year in which the plan is adopted or within the succeeding taxable year, including (but not limited to) a distribution which meets the requirements of subsection (b).

For purposes of section 562 (b) (relating to the dividends paid deduction) and section 6043 (relating to information returns), a partial liquidation includes a redemption of stock to which section 302 applies.

(b) TERMINATION OF A BUSINESS.—A distribution shall be treated as a distribution described in subsection (a) (2) if the requirements of paragraphs (1) and (2) of this subsection are met.

(1) The distribution is attributable to the corporation's ceasing to conduct, or consists of the assets of, a trade or business which has been actively conducted throughout the 5-year period immediately before the distribution, which trade or business was not acquired by the corporation within such period in a transaction in which gain or loss was recognized in whole or in part.

(2) Immediately after the distribution the liquidating corporation is actively engaged in the conduct of a trade or business, which trade or business was actively conducted throughout the 5-year period ending on the date of the distribution and was not acquired by the corporation within such period in a transaction in which gain or loss was recognized in whole or in part.

Whether or not a distribution meets the requirements of paragraphs (1) and (2) of this subsection shall be determined without regard to whether or not the distribution is pro rata with respect to all of the shareholders of the corporation.

(c) TREATMENT OF CERTAIN REDEMPTIONS.—The fact that, with respect to a shareholder, a distribution qualifies under section 302 (a) (relating to redemptions treated as distributions in part or full payment in exchange for stock) by reason of section 302 (b) shall not be taken into account in determining whether the distribution, with respect to such shareholder, is also a distribution in partial liquidation of the corporation.

Miscellaneous

S. Rep. No. 1622, 83rd Cong., 2d Sess. (3 U.S.C. Cong. & Adm. News (1954), pp. 4892, 4899, 4900):

* * * *

Subpart A—Effects on Recipients

§ 331. Gain or loss to shareholders in corporate liquidations

Section 331 restates in effect the provisions of section 115 (c) of the 1939 Code by providing in paragraph (1) that amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock of the shareholder. Paragraph (2) provides that amounts distributed in partial liquidation of a corporation shall be treated as in part or full payment in exchange for the stock of a shareholder.

The term "partial liquidation" is defined in section 346. Such term as here defined differs considerably from that provided in the House bill at section 336. The term "complete liquidation," unlike the House version, is not defined in your committee's bill.

Subsection (b) of section 331 relating to distributions in liquidation of a corporation is intended to make clear that section 301 shall not apply to any distribution of property in partial or complete liquidation of a corporation. This subsection has been inserted by your committee to clarify the treatment of certain redemptions of stock which, while entitled to capital-gains treatment under section 302 (a), are nevertheless not made in connection with a partial or complete liquidation of the corporation. Such portion of section 115 (c) of the 1939 Code which provides for capital-gains treatment where the redemption does not

terminate a part of the business of the corporation is, under your committee's bill, treated under section 302, or section 301, as the case may be.

* * *

Subpart D—Definition

§ 346. Partial liquidation defined

This section provides rules for the determination of when a distribution by a corporation will be considered to be one in partial liquidation so that amounts distributed will be treated as in part or full payment in exchange for the stock under section 331 (a) (2), rather than as a distribution of property in redemption of stock to which section 302 applies which may be treated as a dividend to the extent of corporate earnings by reason of section 302 (d) and section 301.

Subsection (a) is intended to provide a definition of partial liquidation which replaces that contained in section 115 (i) of the 1939 Code. Primarily, this definition involves the concept of "corporate contraction" as developed under existing law. A distribution shall be treated as in partial liquidation if it is one of a series in redemption of all of the stock of a corporation pursuant to a plan or if the distribution is not essentially equivalent to a dividend and is in redemption of a part of the stock of a corporation pursuant to a plan of partial liquidation and occurs within the taxable year in which the plan is adopted or within the succeeding taxable year.

It is intended that a genuine contraction of the business as under present law will result in partial liquidation. See, for example, Joseph Imler (11 T.C. 836). However, a distribution of a reserve for expansion is not a partial liquidation.

Subsection (b) provides a description of one kind of distribution which will be considered as being in partial liquidation. Paragraphs (1) and (2) contemplate that the distributing corporation must be engaged in the active conduct of at least 2 businesses which have been actively conducted (whether or not by it) for the 5-year period ending on the date of the distribution. Neither of such businesses may have been acquired within such period in a transaction in which gain or loss was recognized in whole or in part. Thus, a qualifying business may not have been acquired by purchase or in a corporate reorganization where so-called "boot" was present. If these requirements are met, one of the active businesses may be distributed in kind (or the proceeds of sale of such a business may be distributed) as long as the corporation immediately after the distribution is engaged in the active conduct of a business as described above. The determination of whether the requirements of subsection (b) have been met shall be made without regard to whether the distribution is pro rata among the shareholders of the corporation.

Under subsection (c) if a distribution to a shareholder qualifies under section 302 (a) (relating to redemptions treated as distributions in part or full payment in exchange for stock), and also qualifies as a distribution in partial liquidation by reason of a corporate contraction, then any restriction upon the shareholder which would be imposed by any provision of section 302 shall not apply to such shareholder. For example, if a shareholder terminates his interest in a corporation pursuant to a partial liquidation in which he and his son each owned half the stock, there would be no sanction under section 302 (c) (2) (A) in the event of his reacquiring an interest in the corporation within 10 years from the date of the distribution.

Treasury Regulations, Internal Revenue Code of 1954:

Sec. 1.331-1.

(a) Section 331 contains rules governing the extent to which gain or loss is recognized to a shareholder receiving a distribution in complete or partial liquidation of a corporation. Under section 331 (a) (1), it is provided that amounts distributed in complete liquidation of a corporation shall be treated as in full payment in exchange for the stock. Under section 331 (a) (2), it is provided that amounts distributed in partial liquidation of a corporation shall be treated as in full or part payment in exchange for the stock. For this purpose, the term "partial liquidation" shall have the meaning ascribed in section 346. If section 331 is applicable to the distribution of property by a corporation, section 301 (relating to the effects on a shareholder of distributions of property) has no application.

Sec. 1.346-2.

If a distribution in a redemption of stock qualifies as a distribution in part or full payment in exchange for the stock under both section 302 (a) and this section, then only this section shall be applicable. None of the limitations of section 302 shall be applicable to such redemption.

Revenue Rulings:

SECTION 115 (g).—DISTRIBUTIONS BY CORPORATIONS: REDEMPTION OF STOCK

REGULATIONS 118, SECTION 39.115 (g)-1: Rev. Rul. 58-614
Distribution in redemption or cancellation of stock taxable as a dividend.

The Internal Revenue Service will follow the decision of the United States Court of Appeals for the Third Circuit,

rendered September 3, 1958, in the case of *Joseph R. Holsey et ux* v. *Commissioner,* in cases involving similar facts and circumstances.

The decision holds that a remaining shareholder of a corporation does not receive a constructive dividend by way of enhancement in the value of his stock as a result of a purchase by the corporation of another shareholder's stock.

In the future, the Service will not treat the purchase by a corporation of one shareholder's stock as a dividend to the remaining shareholders merely because their percentage interests in the corporation are increased. On the other hand, if the stock is in reality purchased by a remaining shareholder and paid for by the corporation, then, regardless of the form of the transaction, the payment will be considered a dividend to the shareholder who made the purchase. This position is in accord with the decisions of *H. F. Wall* v. *Commissioner,* 164 Fed. (2d) 462, *Louis H. Zipp* v. *Commissioner,* affirmed by the United States Court of Appeals for the Sixth Circuit, May 21, 1958, and similar court holdings.

In these transactions, if a shareholder surrenders stock to a corporation for less than its fair market value, such surrender may be a gift or compensation to the shareholders who remain interested in the corporation. Conversely, if a corporation pays more than fair market value for its stock, the payment may be compensation to the shareholder surrendering stock or may be a gift to him from the shareholders who remain interested in the corporation.

* * *

SUBCHAPTER C.—CORPORATE DISTRIBUTIONS AND ADJUSTMENTS

PART I.—DISTRIBUTIONS BY CORPORATIONS

Subpart A.—Effects on Recipients

SECTION 302.—DISTRIBUTIONS IN REDEMPTION OF STOCK

26 CFR 1.302-1: General. Rev. Rul. 59-286

Two brothers each owned 50 percent of the stock of a corporation, subject to an agreement providing that upon the death of either of them the survivor would either purchase the stock of the decedent or vote his stock for liquidation of the corporation. One brother died, and the corporation redeemed all of the shares held by his estate at fair market value for valid business reasons. *Held*, the redemption by the corporation of all of its stock held by the estate did not constitute a payment of a constructive dividend to the remaining shareholder.

Advice has been requested whether a stock redemption by a corporation from an estate, the stock having originally been held equally by two brothers, constitutes a constructive dividend to the remaining shareholder.

Two brothers, *B* and *C*, had each owned 50 percent of the stock of a corporation. *C* died in the preceding year. The executors of his estate were a bank and his brother, *B*. Neither the bank nor *B* were beneficiaries of the estate.

B was a party to a stockholders' agreement which provided, in part, that upon the death of either stockholder the survivor would, within six months, either purchase the stock of the deceased at its fair market value, or vote his stock for dissolution and liquidation of the corporation.

Although *C*'s death, had fixed the liability under this agreement, *B* and *C*'s representatives decided to have the

corporation redeem the shares held by the estate for corporate business reasons. Accordingly, the corporation redeemed such stock at its fair market value.

Under the terms of the stockholders' agreement, *B* was personally obligated either to purchase *C*'s stock or to vote his stock for liquidation of the corporation. The corporate action in redeeming *C*'s stock relieved him of his personal obligation under the agreement. However, at no time did *B* purchase the redeemed shares or obligate himself to do so; consequently, the instant case is distinguishable from the case of *Wall* v. *United States*, 164 Fed. (2d) 462. The taxpayer in the *Wall* case had purchased the stock of the other shareholder before the redemption took place so that he was the sole shareholder at the time his personal note was satisfied by the corporation in return for the stock.

Two other decided cases material to the issue, each involving the tax consequences to one shareholder of the redemption of another's stock, are *Joseph R. Holsey et ux.* v. *Commissioner*, 258 Fed. (2d) 865, and *Ray Edenfield* v. *Commissioner*, 19 T.C. 13, acquiescence, C.B. 1953-1, 4. In the *Holsey* case, the Tax Court of the United States held that the law imposed a dividend tax on *A* on the theory that a corporate redemption of *B*'s shares had been undertaken for *A*'s benefit. The United States Court of Appeals for the Third Circuit reversed this decision, pointing out that the benefit received by *A* was too indirect to support the imposition of a dividend tax. The appellate court said that it is, of course, true that the taxpayer was benefited indirectly by the distribution. The value of his own stock was increased, since the redemption was for less than book value, and he became the sole stockholder. But these benefits operated only to increase the value of the taxpayer's stock holdings; they could not give rise to taxable income within the meaning of the Sixteenth Amendment until the

corporation makes a distribution to the taxpayer or his stock is sold. In the *Edenfield* case, the taxpayer and his associates purchased part of the shares of a corporation and, concurrently, it was arranged to have the remaining outstanding shares redeemed by the corporation. The Government contended that payments of the corporate indebtedness created by this redemption constituted dividends to the taxpayer. However, the Tax Court held for the taxpayer.

In both the *Edenfield* and *Holsey* cases, the Government was seeking to tax one shareholder on the redemption of another stockholder's shares on the theory that the redemption was accomplished for the benefit of the first shareholder. However, the Internal Revenue Service has acquiesced in the *Edenfield* opinion and has agreed to follow the Court of Appeals decision in the *Holsey* case in similar factual circumstances. See Rev. Rul. 58-614, C.B. 1958-2, 920.

Although the *Edenfield* and *Holsey* cases, *supra*, are distinguishable from the instant case, there is no authority affirmatively supporting the proposition that a redemption of one stockholder's shares, at fair market value, constitutes a dividend to a remaining shareholder. If in reality the stock is purchased by the remaining shareholder and paid for by the corporation the payment by the corporation will be considered a constructive dividend to the remaining shareholder. See Rev. Rul. 58-614, *supra*.

In the instant case, *B* neither before nor after the redemption can be considered to have possessed the shares of stock redeemed from *C*'s estate. Accordingly, it is held that a redemption by the corporation of the decedent shareholder's shares of the corporation's stock from his estate does not constitute a constructive dividend to the remaining shareholder.

APPENDIX B

The Decisions Below*

UNITED STATES DISTRICT COURT
WESTERN DISTRICT OF MISSOURI

WILLIAM J. SULLIVAN And GEORGIA K. SULLIVAN, Plaintiffs,

v.

UNITED STATES OF AMERICA, Defendant.

Civ. A. No. 14661-4.

June 29, 1965.

BECKER, District Judge.

This is an action by plaintiffs William J. Sullivan and Georgia K. Sullivan, his wife, to recover federal income taxes and interest thereon, alleged to have been erroneously assessed and collected by the defendant. There has been compliance with all statutory conditions precedent to filing of this action. Jurisdiction to determine this controversy exists under Section 1346(a) (1), Title 28, U.S.C.A.

The plaintiffs filed a timely joint federal income tax return for the calendar year 1956. Thereafter, the District Director of Internal Revenue determined that the plaintiff William J. Sullivan received during the year 1956 additional income equivalent to a dividend, in the amount of $198,334.58 from the Sullivan-Nelson Chevrolet Company, a corporation (hereinafter designated the "corporation"

*The decision of the Court of Appeals for the Eighth Circuit appears in the Record, "Proceedings in the United States Court of Appeals for the Eighth Circuit," page 1.

regardless of changes in name), as a result of the purchase or redemption by the corporation of the stock in the corporation owned by Frank W. Nelson. On the basis of this determination, additional income tax for the year 1956 in the sum of $150,166.55, plus accrued interest in the sum of $53,150.70, was assessed against the plaintiffs. Payment of the additional tax and interest was made by plaintiffs on or about March 8, 1963, in the sum of $203,317.25. Thereafter, on March 26, 1963, plaintiffs received a refund in the amount of $98.81 on the ground that the original assessment was incorrect to that extent. The amount now in controversy is the net payment of $203,218.44, plus interest.

Question for Determination

The sole question for determination in this action is whether the plaintiff William J. Sullivan received income equivalent to a dividend (a constructive dividend) in the amount of $198,334.58 during the taxable year 1956 when the corporation purchased or redeemed the shares of stock therein owned by Frank W. Nelson.

Applicable Statutory Provisions

The statutory provisions applicable in the determination of this action are the following portions of Sections 302 and 316 of the Internal Revenue Code of 1954 (Sections 302 and 316 of Title 26, U.S.C.A.):

"§ 302. Distributions in redemption of stock

"(a) General rule.—If a corporation redeems its stock (within the meaning of section 317(b)), and if paragraph (1), (2), (3), or (4) of subsection (b) applies, such redemption shall be treated as a distribution in part or full payment in exchange for the stock.

"(b) Redemptions treated as exchanges.—

"(1) Redemptions not equivalent to dividends.—Subsection (a) shall apply if the redemption is not essentially equivalent to a dividend.

"(2) Substantially disproportionate redemption of stock.—

"(A) In general.—Subsection (a) shall apply if the distribution is substantially disproportionate with respect to the shareholder.

"(B) Limitation.—This paragraph shall not apply unless immediately after the redemption the shareholder owns less than 50 percent of the total combined voting power of all classes of stock entitled to vote.

"(C) Definitions.—For purposes of this paragraph, the distribution is substantially disproportionate if—

"(i) the ratio which the voting stock of the corporation owned by the shareholder immediately after the redemption bears to all of the voting stock of the corporation at such time,

is less than 80 percent of—

"(ii) the ratio, which the voting stock of the corporation owned by the shareholder immediately before the redemption bears to all of the voting stock of the corporation at such time.

For purposes of this paragraph, no distribution shall be treated as substantially disproportionate unless the shareholder's ownership of the common stock of the corporation (whether voting or non-voting) after and before redemption also meets the 80 percent requirement of the preceding sentence. For purposes of the preceding sentence, if there is more than one class of common stock, the determinations shall be made by reference to fair market value.

"(D) Series of redemptions.—This paragraph shall not apply to any redemption made pursuant to a plan the purpose or effect of which is a series of redemptions resulting in a distribution which (in the aggregate) is not substantially disproportionate with respect to the shareholder.

"(3) Termination of shareholder's interest.—Subsection (a) shall apply if the redemption is in complete redemption of all of the stock of the corporation owned by the shareholder."

"§ 316. Dividend defined

"(a) General rule.—For purposes of this subtitle, the term 'dividend' means any distribution of property made by a corporation to its shareholders—

"(1) out of its earnings and profits accumulated after February 28, 1913, or

"(2) out of its earnings and profits of the taxable year (computed as of the close of the taxable year without diminution by reason of any distributions made during the taxable year), without regard to the amount of the earnings and profits at the time the distribution was made."

Regulations and Revenue Rulings Relied on by Plaintiffs

In support of their claim for relief, plaintiffs rely upon the following Income Tax Regulations under the 1954 Internal Revenue Code: Sections 1.302-1, 1.316-1, and 1.317-1. Since this case is decided upon the statutes involved and the judicial decisions construing the statutes, and since there is no disagreement concerning the interpretation of the regulations, the regulations will not be set out in detail.

The Revenue Rulings relied upon by the plaintiffs are as follows: Revenue Ruling 614, 1958-2 Cum.Bull. 920 and Revenue Ruling 286, 1959-2 Cum.Bull. 103.

FINDINGS OF FACT

In February, 1941, the plaintiff William J. Sullivan (hereinafter designated "Sullivan"), a resident of Kansas City, Missouri, acquired a Chevrolet franchise in Blytheville, Arkansas. In the same month, to exploit the franchise, Sullivan formed the Loy Eich Chevrolet Company, an Arkansas corporation, with its principal place of business in Blytheville, Arkansas. Its authorized capital stock consisted of 1,000 shares of common stock, having a par value of $100 each. The corporation commenced business upon the issuance of 300 shares of its capital stock, which was issued at par value. Its initial shareholders were plaintiffs Sullivan and Georgia K. Sullivan (hereinafter designated "Mrs. Sullivan"), holding 290 shares, and Loy B. Eich and Ruth Eich, holding 10 shares. The name of the corporation, Loy Eich Chevrolet Company, was changed on February 21, 1948, to the Sullivan-Nelson Chevrolet Company, and thereafter again changed on May 8, 1956, to the Kaw Finance Company.

In 1941, Loy B. Eich (hereinafter designated "Eich") was employed as resident manager of the corporation, and continued to manage the corporate business until February of 1948. Between 1941 and 1948, Eich acquired by purchase an additional 110 shares of stock in the corporation so that his total holdings in February of 1948 were 120 shares, which were 40 percent of the outstanding 300 shares. On March 17, 1946, Eich (then owning 30 percent of the stock of the corporation) and Sullivan (then owning or controlling through his and his wife's ownership 70 percent of the stock of the corporation) entered into a

written agreement whereby Eich acknowledged that the Chevrolet franchise for Blytheville, Arkansas, and contiguous territory was the individual property of the plaintiff Sullivan, though nominally owned by Sullivan and Eich. In the written agreement, Eich further agreed to surrender the stock in the corporation owned by him, upon demand by Sullivan at any time in the future, and further agreed to sell his stock to Sullivan at its net worth and book value determined from the company's books and financial statement.

In February, 1948, Sullivan purchased all the shares in the corporation owned by Eich and his wife. Following this purchase Sullivan and Mrs. Sullivan owned all the issued and outstanding capital stock of the corporation, a total of 400 shares. Sullivan then entered into negotiations with Frank W. Nelson (hereinafter designated "Nelson") to secure Nelson's services as resident manager of the corporation. Nelson had been employed since 1944 by Sullivan as general manager of a Chevrolet dealership in Kansas City, Missouri.

After negotiations, Sullivan and Nelson entered into a written contract dated September 10, 1948, signed by Nelson on September 10, 1948, and by Sullivan on September 14, 1948 (Plaintiffs' Ex. 4). The material provisions of this contract (hereinatfer designated "memorandum agreement") are as follows:

"MEMORANDUM AGREEMENT

"This agreement made and entered into this 10th day of September, 1948, by and between William J. Sullivan of Kansas City, Missouri hereinafter called 'Sullivan' and Frank Nelson of Blytheville, Arkansas, hereinafter called 'Nelson', witnesseth:

* * * * * *

"WHEREAS, Loy B. Eich has since retired from the business and severed his connection with the corporation and sold and transferred his stock in the Loy B. Eich Chevrolet Company to said William J. Sullivan and the corporate name has been changed to Sullivan-Nelson Chevrolet Co.; all of the stock of the corporation is owned by William J. Sullivan and Georgia Sullivan except one qualifying share owned by the undersigned, Frank Nelson, and

* * * * * *

"WHEREAS, said Nelson desires to purchase shares of stock in the Sullivan-Nelson Chevrolet Co. and own said shares as long as he is living and physically capable of managing and is manager of said company or of said corporation, and Sullivan desires to sell and transfer some shares of stock to said Nelson as herein provided and upon the following terms and conditions.

NOW, THEREFORE, IT IS MUTUALLY AGREED AS FOLLOWS:

* * * * * *

"4. ACQUISITION OF SHARES OF STOCK BY NELSON. Said Nelson desires to purchase shares of stock in the corporation as aforesaid and now has the sum of seventeen thousand, five hundred dollars ($17,500.00) for such purpose, and desires to purchase at book value such number of shares of stock as said amount of money will purchase. In determining the value of shares of stock at this time, or at any time in the future, and in now determining the amount which said Nelson shall pay for such shares, the parties have agreed on the rule of book value and book value is defined as follows: 'The capital, the surplus, and the undivided profits, divided by the number of shares issued and outstanding.' * * * Nelson may acquire up to but not more than forty (40) per cent of the stock of the corporation issued and outstanding, after the issue of such stock to him.

"5. HOW VALUE OF STOCK AND PRICE AS TO PURCHASE AND SALE IS DETERMINED. The price of a share of stock in the corporation when purchased or sold by Nelson shall be determined from an adjusted monthly financial statement as of the close of business as of the last day of the preceding month. Such statement shall be used by the parties including their heirs, executors, and administrators in determing (sic) the book value of the stock as defined in paragraph four above.

"6. TRANSFER OF SHARES OF STOCK. It is understood and agreed that Sullivan is permitting Nelson to buy stock in said corporation for the purpose of giving him a working interest only, and said Nelson agrees that said shares of stock cannot and will not be mortgaged, hypothecated or transferred by him, his heirs, executor, administrator or trustee to any person other than William J. Sullivan or such person as said Sullivan directs in writing. Any such sale, delivery or transfer to any other person, firm or corporation shall be null and void. Said Sullivan agrees that he will, within thirty (30) days after such shares have been offered for sale to him, accept the offer to sell, provided always that such shares shall be offered for sale at a price to be determined according to this contract.

"7. TERMINATION OF CONTRACT. Said Nelson agrees that if he should terminate his employment or relationship with William J. Sullivan or employment by the said corporation, and if his connection and association with the corporation should cease or be terminated by Sullivan or the majority owners of the stock of the corporation, then said Nelson agrees to sell and transfer and deliver to Sullivan at the then book value all shares of stock owned by him in the Sullivan-Nelson Chevrolet Co. * * * If said contract is terminated by Nelson or Sullivan as herein provided or by the death of Nelson, the value of the stock owned by Nelson shall be fixed and determined as set up in paragraphs four and five of this agreement.

If said Nelson should die or become so disabled by injury or sickness as to become incapable of managing and operating the business, then said Sullivan shall have the immediate and exclusive right to purchase the stock owned by Nelson or by his heirs, administrators or executors in accordance with the terms of this contract. Title so (sic) said shares of stock shall automatically rest in Sullivan upon Nelson's death and said Sullivan shall be obligated to Nelson's personal representative or representatives for the value thereof as fixed by this agreement."

According to the minutes of the corporation, on September 10, 1948, a special meeting of the Board of Directors of the corporation was held in Blytheville, Arkansas. At that meeting the following resolution was adopted (Plaintiffs' Ex. 3):

" 'WHEREAS William J. Sullivan, president of this corporation and Frank Nelson, both of whom are directors of this corporation have this 10th day of September, 1948 entered into an agreement covering the terms of the issuance by this corporation to said Frank Nelson of thirty-three (33) shares of stock in this corporation, and

"WHEREAS it is deemed by the board of directors of this corporation to be to the best interests of the corporation to issue such stock to said Frank Nelson subject to the terms and conditions of the aforesaid agreement,

"NOW THEREFORE, BE IT RESOLVED that the memorandum agreement entered into by and between said William J. Sullivan and Frank Nelson be and its terms are hereby ratified and adopted by this corporation, and

"BE IT FURTHER RESOLVED that a copy of this agreement herein described be attached to these minutes and marked 'Exhibit A'."

The approval of the minutes of this meeting was signed by plaintiffs and Nelson. Notice of this agreement was typed on certificates of shares of stock in the corporation issued to Nelson in 1948 and early 1949.

Plaintiffs offered the oral testimony of the witness Nelson contained in his deposition taken March 10, 1964; the oral testimony of the plaintiff Sullivan concerning the negotiations and events leading up to the execution of the memorandum agreement of September 1948; and the oral testimony of Samuel L. Trusty, Esquire, a member of the Kansas City Bar and formerly a member of the firm Trusty and Pugh, which was counsel for the plaintiff Sullivan in 1948. (Mr. Pugh was not living at the time of the hearing.) These witnesses testified concerning the events of 1948. Plaintiffs also offered the oral testimony of J. D. Widner, general manager of the corporation since 1956, and of Merle Clements, certified public accountant and attorney of Memphis, Tennessee, who advised Sullivan and Nelson in 1956 concerning the purchase of Nelson's stock in the corporation in that year.

This oral evidence was offered to prove that the plaintiff Sullivan and Nelson intended and orally agreed that Sullivan would not be personally obligated to redeem Nelson's stock; and that this oral agreement was reduced to writing in the memorandum agreement by Trusty and Pugh as attorneys for the plaintiff Sullivan.

Plaintiffs then claim that, when construed in the light of the extrinsic oral and documentary evidence, including the above quoted corporate minutes of September 10, 1948, the written memorandum agreement obligated the corporation to buy Nelson's stock, and did not obligate the plaintiff Sullivan to buy Nelson's stock. In plaintiffs' brief the evidence is summarized and the plaintiffs' contentions submitted in the following language:

"In February of 1941, when Eich acquired the 10 shares of stock and became an officer and director of the Corporation and its resident manager, his relationship with the Corporation and Sullivan was governed only by an oral agreement. Thereafter, on March 17, 1946, this Agreement was reduced to writing by execution of a Memorandum of Agreement by and between Sullivan and Eich. (Tr. 19, 20) Under the aforesaid Agreement, Sullivan was obligated to purchase Eich's stock in the Corporation in the event Eich's employment was terminated. (Tr. 22)

"On February 21, 1948, because of disagreement between Eich and Sullivan, Eich resigned from the Corporation and sold Sullivan all of his stock therein. (Tr. 21, 22, 28; P. Ex. 2) At this time, Eich and his wife owned 120 shares of stock of the Corporation. (Tr. 23) Sullivan paid Eich $570.00 per share for the 120 shares of stock, the consideration being paid from Sullivan's own funds. (Tr. 23, 24) At this time, February 21, 1948, upon the purchase of Eich's stock, Sullivan and his wife owned all of the issued and outstanding stock of the Corporation. (Tr. 38, 39; Stip. par. 16)

"Sullivan first became acquainted with Frank Nelson, hereinafter sometimes referred to as Nelson in about 1932. (Tr. 24) Nelson acquired considerable experience in the automobile dealership field and related activities, during the period 1926 through June, 1944. (Dep. pp. 7-10) On June 1, 1944, Nelson was employed by the Bill Sullivan Chevrolet Company, Kansas City, Missouri, as general manager. (Dep. p. 9) Nelson is related in no way to Sullivan or his wife. (Dep. p. 5)

"Nelson remained in Kansas City as general manager of the Bill Sullivan Chevrolet Company until February of 1948. (Dep. p. 11) On February 18, 1948, Sullivan asked Nelson if he would like to become the Chevrolet dealer in Blytheville, Arkansas. Nelson in-

dicated that he would be interested in the proposition, the two men departed for Memphis, Tennessee that same evening, and arrived in Blytheville, Arkansas a day or so later. (Dep. p. 16; Tr. 25) On the trip to Blytheville, Sullivan and Nelson discussed the terms of Nelson's employment by the Corporation and the arrangement whereby Nelson would be permitted to purchase stock of the Corporation. (Dep. p. 17; Tr. 31) Sullivan and Nelson agreed that Nelson would receive a salary of $12,500.00 per year, plus 10 percent of the net profit before taxes, and 10 percent of the commissions on insurance. (Dep. p. 18) Nelson agreed to sell his house in Kansas City and purchase as many shares of stock in the Corporation as the sale's proceeds would permit. The cost of the initial block of stock to be purchased was to be based on the book value of the stock as of February 28, 1948, which was $570.00 per share. (Dep. pp. 17, 18) Sullivan and Nelson further agreed that Nelson would be permitted to purchase a maximum of 40 percent of the issued and outstanding stock of the Corporation. (Dep. 19) *Sullivan and Nelson also agreed that the Corporation, not Sullivan, would be obligated to buy Nelson's stock.* (Tr. 115)

"Special meetings of the directors and stockholders of the Corporation were held on February 21, 1948, at which time Eich resigned from the Board of Directors, Nelson was elected to the Board of Directors and one share of stock, a qualifying share, was issued to Nelson. (Dep. p. 20; P. Ex. 1, 2; Tr. 28-30) Thereafter, until May, 1956, Nelson continued as a stockholder, director, and officer of the Corporation and its resident manager, in Blytheville, Arkansas. (Dep. p. 22)

"In September, 1948, the oral agreement which had heretofore governed the relationship of Sullivan, Nelson and the Corporation, was reduced to writing and incorporated in Plaintiff's Exhibit 4, entitled 'Memorandum Agreement', hereinafter sometimes re-

ferred to as the 'Memorandum Agreement'. (Dep. p. 25; Tr. 31; p. Ex. 4) Because of the necessity of selling his house, moving his family, and obtaining approval from the Chevrolet Motor Company for the sale of Sullivan's stock to Nelson, it was not possible to consummate the Memorandum Agreement prior to September, 1948. (Dep. pp. 26-27) Early in September, 1948, Sullivan contacted his attorneys, Sam Trusty and Ed Pugh, in Kansas City, Missouri, and gave them instructions respecting the drafting of the Memorandud (sic) Agreement. (Tr. 33-34, 131)

"Trusty and Pugh were familiar with the Loy Eich situation since they had prepared the contract between Eich and Sullivan, and Sullivan instructed Trusty and Pugh that he did not want the same situation (wherein he would be personally obligated to redeem Nelson's stock) to develop again. Sullivan instructed Trusty and Pugh to draft an agreement which would not obligate him to purchase Nelson's stock if it were ever offered for sale. (Tr. 33, 34, 37, 130, 132, 133) Trusty and Pugh prepared the Memorandum Agreement, advised Sullivan to go to Blytheville, Arkansas, discuss the Memorandum Agreement with Nelson, and hold a meeting of the Board of Directors of the Corporation, at which time the directors should ratify and adopt the Memorandum Agreement. (Tr. 35, 36, 133) Trusty and Pugh also advised Sullivan to have Nelson sign the Memorandum Agreement but not to sign it himself. (Tr. 36, 134, 135) The Memorandum Agreement was prepared sometime early in September of 1948 and taken by Sullivan to Blytheville, Arkansas, where Sullivan arrived on September 10, 1948. Sullivan and Nelson discussed the Memorandum Agreement and held the meeting of the Board of Directors at which a resolution was passed, the material part of which is quoted below:

"'The president announced that the purpose of the meeting was to authorize the terms under which additional shares of stock in the corporation were to be issued to Frank Nelson. He offered for the consideration of the board a memorandum agreement made on this date between William J. Sullivan of Kansas City, Missouri and Frank Nelson of Blytheville, Arkansas, which agreement was read and examined by the board of directors. Thereupon on motion duly made and seconded the following resolution was unanimously adopted: [Here the above quoted resolution (Plaintiffs' Ex. 3) is set forth.]'

"Nelson signed the Memorandum Agreement in Blytheville, Arkansas, on September 10, 1948, and Sullivan returned to Kansas City with the Agreement. (Tr. 36; P. Ex. 3) Sullivan again met with Trusty and Pugh and related to them the events which had taken place at the Directors' meeting. Whereupon, Trusty prepared the resolution of the Board of Directors and the language thereof was read over the telephone to Nelson, who had remained in Blytheville. (Tr. 135) The Directors' resolution adopted at the meeting of September 10, 1948, was then executed. (Tr. 36, 38; P. Ex. 3; Tr. 135) Thereafter on September 14, 1948, Sullivan signed the Memorandum Agreement. (Tr. 36, 38, 134, 135; P. Ex. 4)

"Sullivan's attorney, Mr. Trusty, advised Sullivan that the Corporation's ratification and adoption of the Memorandum Agreement would result in the Corporation being obligated to purchase Nelson's stock; but that under the Memorandum Agreement Sullivan would be obligated to sell to Nelson 40 percent of the issued and outstanding stock of the Corporation. (Tr. 133, 134)

"Nelson advised Sullivan that he wanted the Corporation obligated to buy his stock anytime he desired to sell it. (Tr. 42, 133; Dep. 29, 30) Nelson insisted on

the Corporation being obligated to repurchase his stock because of the possibility that Sullivan might die and because he wanted the Corporation by which he was employed and in which he would invest his money to be responsible. (Dep. p. 29; Tr. 41, 133) Nelson understood that under the Memorandum Agreement of September 10, 1948, he had the right to buy shares of stock in the Corporation from Sullivan and his wife, only, and that he had no right to buy shares of stock from the Corporation. (Dep. 61, 62; Tr. 134) Nelson did not desire to buy stock from the Corporation because he believed the purchase of unissued shares of stock would dilute his holdings. (Dep. 62) Nelson understood that under the Memorandum Agreement, if he were discharged the Corporation would have to buy his stock, that Sullivan alone could not purchase his stock, and that if Nelson died, the corporation would purchase the stock from his widow. (Dep. 59, 61)

"The controlling and material provisions of the Memorandum Agreement of September 10, 1948, executed by and between Sullivan and Nelson, which was adopted by the Corporation, are as follows:" [Here follows the written agreement dated September 10, 1948, between Sullivan and Nelson, the pertinent portions of which are quoted above.] (Emphasis added.)

The oral evidence supports the factual contentions set forth except to the extent that it is not consistent with the unambiguous provisions of the written memorandum agreement dated September 10, 1948. The legal effect of this oral evidence will be discussed hereinafter.

Late in 1955, approximately seven years after the execution of the memorandum agreement, Nelson advised Sullivan that Nelson desired to acquire an automobile dealership of his own because Nelson wanted to own 100 percent of a dealership. Nelson could not acquire 100 percent of the stock of the corporation because he was

limited by the memorandum agreement to acquisition of no more than 40 percent of the stock of the corporation.

In early 1956, Nelson negotiated the purchase of a Chevrolet dealership at Poplar Bluff, Missouri and made a down payment thereon in the sum of $5,000.

Thereafter, in April 1956, the corporation purchased (or redeemed) the 114 shares held by Nelson at the book value as of March 31, 1956. The determination of the book value, the preparation of the papers, including the minutes of the corporate meetings, consummating the transaction, were directed by the witness Merle Clements, a partner in the firm of George B. Jones and Company, Certified Public Accountants, of Memphis, Tennessee.

At the time that the corporation redeemed Nelson's stock in 1956, a number of documents were prepared, none of which could have the effect of altering the basic obligations expressly and clearly provided by the written agreement between the plaintiff Sullivan and Nelson and by the action of the corporation in 1948.

Some of these 1956 documents are consistent with the claims which the plaintiffs now make that plaintiff Sullivan did not in 1948 incur an unconditional obligation to purchase Nelson's stock. For example, the corporate minutes of March 9, 1956, (Plaintiffs' Ex. 5) contain approval of a resolution which described the memorandum agreement as granting to Sullivan an option to purchase the shares of stock of Nelson. Furthermore, in his deposition given after this suit was instituted, Nelson testified in support of plaintiffs' claim that the corporation rather than the plaintiff Sullivan was to be obligated to buy Nelson's stock and that the plaintiff Sullivan had no obligation whatsoever. See pages 31 and 32 of Nelson's deposition of March 10, 1964. The closing documents con-

sistent with plaintiffs' claim were prepared in 1956 by the tax consultant and attorney employed to consummate the purchase (or redemption) transaction. It is interesting to note in connection with Nelson's deposition testimony that Nelson took the opposite position in a letter dated March 30, 1956, addressed to the plaintiff Sullivan which reads as follows:

"Dear Bill:

"As I have previously discussed with you, it is my desire to divest myself completely of the ownership of all shares of stock I now hold in the Sullivan-Nelson Chevrolet Company.

"Under the terms of the Memorandum Agreement between us dated September 10, 1948, I must offer these shares for sale to you and you must accept my offer and purchase them at 'book value' as determined in the Agreement.

"I have by a letter dated March 9, 1956, advised the Chevrolet Division of General Motors Corporation of my position in this matter and I await your usual prompt reply."

This letter is obviously inconsistent with Nelson's deposition testimony. Plaintiffs contend that this letter was written by the tax consultant in April 1956 and antedated. The tax consultant so testified (Tr. 170-73). This letter is not decisive and no finding of fact or of failure of proof is based thereon in respect to the construction of the 1948 memorandum agreement.

The evidence shows that Sullivan accepted an oral offer by Nelson to sell his stock, confirmed in the above-quoted letter of March 30, 1956, from Nelson to Sullivan. This offer was also confirmed and accepted by an undated letter from Sullivan to Nelson directing Nelson to transfer

the capital stock to the corporation at the book value. This letter expressly contemplated transfer to the corporation. It reads as follows:

"Dear Mr. Nelson:

"Since ypu (sic) have notified me of your intention of terminating your employment by Sullivan-Nelson Chevrolet Company, and under the terms of our memorandum agreement dated September 10, 1948, you have offered for sale to me, ii4 (sic) shares of the capital stock of Sullivan-Nelson Chevrolet Company at the book value as determined from an adjusted monthly financial statement as of the close of business of the last day of the month preceding your resignation; I invoke the terms of paragraph 6 of said agreement and hereby authorize and direct you to transfer your entire holdings of the capital stock of Sullivan-Nelson Chevrolet Company to said corporation at the book value as aforesaid. * * *"

The purchase (or redemption) of Nelson's stock was consummated out of accumulated earnings of the corporation which were available for declaration of dividends, as shown by the condensed balance sheets of the corporation as of March 31, 1956, and as of April 1, 1956. These balance sheets reflect the changes in the corporate books resulting from the purchase of the Nelson stock. Before the purchase of the Nelson stock the corporation owned a surplus above the original capital stock liability of $491,932.22, designated as "retained earnings"

CONCLUSIONS OF LAW

The decisive legal question in this case is whether the plaintiff Sullivan was primarily obligated to purchase the stock of Nelson, when Nelson decided in 1956 to terminate his employment as resident manager of the corporation and to purchase the Chevrolet dealership in

Poplar Bluff, Missouri. The determination of this question depends upon the legal effect of the negotiations and agreements beginning in February 1948 and culminating in the execution of the written memorandum agreement by the plaintiff Sullivan in Kansas City, Missouri, on September 14, 1948. Since there is no evidence or contention that the memorandum agreement was revoked, modified, or supplemented by any subsequent agreement, the obligation, if any, of the plaintiff Sullivan to purchase Nelson's stock must be determined by the events and writings of 1948, and the events of the period from 1948 to 1956.

If the plaintiff Sullivan was unconditionally and primarily obligated to purchase Nelson's stock in 1956 and if the stock was purchased by the corporation out of profits distributable as a dividend, the plaintiff in 1956 constructively received income equivalent to a dividend in the amount of $198,334.58. This conclusion is required by the holdings of the following controlling decisions and authorities: Holsey v. Commissioner of Internal Revenue (C.A.3) 258 F.2d 865; Wall v. United States (C.A.4) 164 F.2d 462; Woodworth v. Commissioner of Internal Revenue (C.A.6) 218 F.2d 719; 1 Mertens, Federal Taxation, § 9.08, p. 20 (Zimet ed.); Harnett, Buying Out the Disputatious Shareholder, 11 N.Y.U. Institute on Federal Taxation 393. Compare Idol v. Commissioner of Internal Revenue (C.A. 8) 319 F.2d 647; Zipp v. Commissioner of Internal Revenue (C.A.6) 259 F.2d 119.

On the other hand, if the plaintiff Sullivan had no primary obligation to buy Nelson's stock in 1956, or if the plaintiff Sullivan had the right to buy Nelson's stock in 1956 but was not obligated to do so, there was no constructive dividend and plaintiff would be entitled to recover in this suit. Holsey v. Commissioner of Internal Revenue, supra; S. K. Ames, Inc., 46 B.TA.A 1020; Princess Coals,

Inc. v. United States (S.D.W.Va.) 239 F.Supp. 401; 1 Mertens, Federal Taxation § 9.08, p. 20 (Zimet ed.); Harnett, Buying Out the Disputatious Shareholder, supra.

[1] Further, there is no constructive dividend where the taxpayer's obligation in respect to the corporate stock is to "purchase or cause to be purchased". S. K. Ames, Inc., supra.

[2] Moreover, in other words, there is no constructive dividend when the taxpayer has an option to purchase the corporate stock but is not required to do so. Holsey v. Commissioner of Internal Revenue, supra. Acquiescence noted: Rev. Rul. 614, 1958-2 Cum. Bull. 920; Princess Coals, Inc. v. United States, supra.

[3] Similarly, where the obligation of the taxpayer is either to purchase the corporate stock or vote the taxpayer's stock for liquidation of the corporation, there is no constructive dividend. Rev. Rul. 286, 1959-2 Cum. Bull. 103.

The taxpayers assert that the payment by the corporation must be in "payment of a taxpayer's indebtedness" but not merely "in satisfaction of a contractual obligation" to constitute the equivalent of a dividend to the taxpayer. No authority has been found which will support this not wholly clear contention.

Taxpayers also argue that there is no constructive dividend if the taxpayers' obligation to purchase was "executory". If by this argument it is implied that there is no constructive dividend in the case of an unconditional obligation by the taxpayers to purchase the stock, there is no authority to support the proposition. If by this argument it is meant that there is no constructive dividend when the taxpayer has not incurred an unconditional primary obligation to purchase, the argument is consistent

with the conclusions of law above set forth in this opinion. If by this argument it is meant that the obligation was "executory" until Nelson offered to sell, Nelson did offer to sell in 1956 making the obligation of Sullivan to buy an unconditional obligation.

The taxpayers have other principal contentions remaining. The first is that the oral and documentary evidence, extrinsic of the memorandum agreement, when considered with the memorandum agreement, established by a preponderance of the evidence, or as a matter of law, that the plaintiff Sullivan did not unconditionally obligate himself to purchase Nelson's stock; that at most Sullivan reserved an option to purchase Nelson's stock or the option to select another buyer for Nelson's stock.

The second contention of plaintiffs is that the evidence establishes that "the corporation and not Sullivan was obligated to redeem Nelson's stock".

In connection with these contentions, the Government has objected to the consideration of parol evidence in the construction of the taxpayers' agreement in 1948, invoking the parol evidence rule. Against this objection, the taxpayers contend the parol evidence rule is not applicable because (1) the memorandum agreement of 1948 is ambiguous and that, in any event (2) the Government has no standing to invoke the parol evidence rule, since it is a stranger to the agreement. The soundness of these latter two contentions will be settled first.

[4] It is first concluded that the memorandum agreement executed by the plaintiff Sullivan on September 14, 1948, is clear and unambiguous. Therefore the manifest obligations provided thereby are not affected by parol evidence of subjective intentions, inconsistent discussions, oral understandings, and negotiations leading up to its ex-

ecution. In this connection, it is concluded that, in essence, the parol evidence rule as applied here is a rule of substantive law determining the legal obligations of the parties to the memorandum agreement in the light of prior oral negotiations and intentions not reflected in the unambiguous written contract.

[5] It is immaterial that the litigation in which the parol evidence rule is invoked is between a party to the writing and a stranger thereto. Clark v. United States (C.A. 9) 341 F.2d 691.[1] The true test in this case is whether the plaintiff Sullivan was unconditionally and primarily obligated by virtue of the 1948 memorandum agreement to purchase Nelson's stock upon the termination of Nelson's employment as resident manager in 1956 and upon his offer to sell to Sullivan. This obligation for tax purposes is not dependent upon whether Nelson is a party to the action in which the question is decided. If in 1956 Nelson could have maintained an action against Sullivan for breach of unconditional primary obligation to purchase Nelson's stock upon termination of Nelson's employment, there was an absolute, unconditional primary obligation on the part of Sullivan to purchase Nelson's stock for income tax purposes.

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1. Much of the confusion about the doctrine of integration in respect to contracts is caused by the use of the deceptive title "Parol Evidence Rule" to describe the doctrine. The doctrine is not a rule of evidence; it is a rule of substantive law. The doctrine is applicable not only to oral (parol) evidence but applies to writings as well. The discussion in many cases whether the "Parol Evidence Rule" is binding only upon the parties to the document is a false issue which has led to much confusion. See 9 Wigmore, Evidence (3d ed.) § 2446, pp. 149-151. Generally on the nature of the "Parol Evidence Rule" as a rule of substantive law, see the following: Restatement, Contracts, §§ 237-244, in particular § 237, Comment a.; 9 Wigmore, Evidence (3d ed.) §§ 2425-2426, 2429-2453 on integration of bilateral acts; 3 Corbin, Contracts (1951 ed.) §§ 573-596 (in particular § 573 on nature of rule and § 596 on application for or against one not a party to the agreement); McCormick, Evidence (1954) § 213.

The taxpayers cite in support of their claim that the parol evidence rule cannot be invoked by the Government, a stranger to the contract, the following cases: Stern v. Commissioner of Internal Revenue (C.A.2) 137 F.2d 43, 46; Brassert v. Clark (C.A.2) 162 F.2d 967, 973; Scofield v. Greer (C.A.5) 185 F.2d 551, 552; Scott v. Gearner (C.A.5) 197 F.2d 93, 96; Gibson v. United States, 106 U.S.App.D.C. 10, 268 F.2d 586, 599; Cooper Foundation v. O'Malley (D. Neb.) 121 F.Supp. 438, 444.

None of these cases is in point here[2] The parol evidence here has been admitted, considered, and found as a

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2. The Stern case, supra, is not in point. It involved the identity of the source of the *corpus* of a trust created for a wife in settlement of her claims under a separation agreement and suits for alienation and criminal conversation. While the term "parol evidence rule" is loosely used, the issue was whether the *corpus* of the trust was, in fact, derived from the husband's funds or income so that income from the trust should be treated as earnings of the husband. The Brassert case, supra, does not support the plaintiffs' theory of application of the parol evidence rule in any way. It was a suit to determine whether a transfer of patents to an American citizen was a subterfuge, or truly irrevocable so as to be immune from seizure under Section 9(a) of the Trading with the Enemy Act. There, Judge L. Hand properly reviewed all the evidence and found that the transfer was intended to be and was irrevocable. He determined the issue as a matter of substantive law after reviewing the whole of the transaction, saying, at pages 973 and 974 of 162 F.2d:

> "Why then should not all the documents which expressed the actual intent be read together? As between the principal and the agents, the power of attorney may have been an 'integrated memorial' of their agreement; we will assume that the parol evidence rule applied to it. However, that rule does not prevent the entire intent of the parties from appearing—so far as it has been actually expressed—when that intent becomes relevant in a transaction between either party and a third party.[5] ([5]. Indianapolis Glove Co. v. United States, 7 Cir., 96 F.2d 816, 819; Patterson v. Texas Co., 5 Cir., 131 F.2d 998, 1001; Stern v. Commissioner [of Internal Revenue], 2 Cir., 137 F.2d 43, 46; White v. Union Producing Co., 5 Cir., 140 F.2d 176, 179; Wigmore, § 2446.)"

In the Brassert case the issue was whether the transaction was a subterfuge and therefore a fraud. Therefore it is not in point.

matter of law not to affect substantive contractual rights of Sullivan and Nelson under the memorandum agreement. As applied in this case, the parol evidence rule is a rule of substantive law not an evidentiary privilege of the parties. 3 Corbin, Contracts § 573, pp. 356-369; 9 Wigmore, Evidence §§ 2400-2446, pp. 3-149 (3d ed.).

[6-9] The next question to be decided is the crucial question whether plaintiff Sullivan had an unconditional primary obligation to purchase Nelson's stock when Nelson terminated his employment in 1956. It is concluded that Sullivan did have such an obligation. In the first place, the contract must be construed in the light of Nelson's and Sullivan's objective manifest intentions rather than their

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The Scofield case, supra, states that the parol evidence rule is not applicable in a tax refund suit because the Government was not a party or privy to the written agreement concerned. While the case does not recognize the modern view of the parol evidence rule, it reached a correct result and is not inconsistent with the ruling in the case at bar.

In the Scott case, supra, the Court recognized the true nature of the doctrine as a rule of substantive law by relying on 9 Wigmore, Evidence (3d ed.) § 2446, which states at page 150:

> "The truth seems to be, then, that the rule will still apply to exclude extrinsic utterances, even as against other parties, provided it is sought to use those utterances *for the very purpose for which the writing has superseded them as the legal act.*" (Emphasis Wigmore's.)

The Gibson case, supra, was a criminal case in which Wigmore and Corbin are cited and relied upon, along with the statements of law repudiated by Corbin and Wigmore. While loose language supporting plaintiffs' conception of the rule is used, the case reaches a correct result. In the Cooper case, supra, the challenged evidence was received in a tax refund suit over the objection of the Government. This ruling relied on a loose statement of the parol evidence rule from 32 C.J.S. Evidence § 861, p. 791, (now 32A C.J.S. Evidence § 861, p. 224). This type of ruling is accurately described in 9 Wigmore, Evidence (3d ed.) § 2446, p. 149, as follows:

> "It is commonly said that the Parol Evidence rule, in the present aspect, is *binding upon only those persons who are parties to the document.* This form of statement suffices in most instances to reach correct results; but it is not sound on principle." (Emphasis Wigmore's.)

subjective intentions or interpretations. This is the general rule in contract cases. Restatement, Contracts §§ 2 and 70, pp. 25 and 73 (1932). (The exceptions to the general rule are not material. Sections 55, 71, and 72). Therefore, only the writings, the negotiations, and the circumstances known to Nelson and Sullivan can be considered in construing the contract. The private discussions between Sullivan and his attorneys, not known to Nelson when the contract was made, are immaterial.

Paragraph 6 of the written memorandum agreement contains an unconditional primary obligation on the part of Sullivan to buy. This paragraph is as follows:

> "6. TRANSFER OF SHARES OF STOCK. It is understood and agreed that Sullivan is permitting Nelson to buy stock in said corporation for the purpose of giving him a working interest only, and said Nelson agrees that said shares of stock cannot and will not be mortgaged, hypothecated or transferred by him, his heirs, executor, administrator or trustee to any person other than William J. Sullivan or such person as said Sullivan directs in writing. Any such sale, delivery or transfer to any other person, firm or corporation shall be null and void. *Said Sullivan agrees that he will, within thirty (30) days after such shares have been offered for sale to him, accept the offer to sell, provided always that such shares shall be offered for sale at a price to be determined according to this contract.*" (Emphasis added.)

Plaintiffs contend that the first two sentences of Paragraph 6 of the memorandum agreement clearly provide that Sullivan is not unconditionally obligated to purchase Nelson's stock. In the alternative, plaintiffs contend that, if these two sentences do not clearly provide that Sullivan may, at his option, cause the stock to be purchased by a stranger to the contract, an ambiguity and uncertainty in

Sullivan's obligation are created thereby, rendering the parol evidence of intention applicable and decisive in favor of the plaintiffs.

[10, 11] Harmonious and consistent construction of all the provisions of the memorandum agreement and contemporaneous documents can be and should be made. The obligation to purchase is not inconsistent with, or rendered ambiguous or unclear by, a restrictive covenant on the part of the seller to transfer only to the buyer or some person designated in writing by the buyer. Therefore, the first two sentences of Paragraph 6 of the memorandum agreement do not create an option to purchase (as in the Holsey case) or an alternative obligation to purchase or cause to be purchased (as in the Ames case). At most, Sullivan had an option to designate the transferee of Nelson's stock when purchased by Sullivan.

Upon the termination of his employment or relationship with Sullivan as provided in Paragraph 7 of the memorandum agreement dated September 10, 1948, Nelson was obligated to sell, transfer, and deliver to Sullivan all his shares of stock. The pertinent portion of Paragraph 7 is as follows:

> "Said Nelson agrees that if he should terminate his employment or relationship with William J. Sullivan or employment by the said corporation, and if his connection and association with the corporation should cease or be terminated by Sullivan or the majority owners of the stock of the corporation, *then said Nelson agrees to sell and transfer and deliver to Sullivan at the then book value all shares of stock owned by him in the Sullivan-Nelson Chevrolet Co.* * * *" (Emphasis added.)

[12] The sale price was fixed with sufficient definiteness to constitute an enforceable obligation by Paragraph 5 of the memorandum agreement, which is as follows:

"5. HOW VALUE OF STOCK AND PRICE AS TO PURCHASE AND SALE IS DETERMINED. The price of a share of stock in the corporation when purchased or sold by Nelson shall be determined from an adjusted monthly financial statement as of the close of business as of the last day of the preceding month. Such statement shall be used by the parties including their heirs, executors and administrators in determing (sic) the book value of the stock as defined in paragraph four above."

The obligation of Sullivan to purchase became fixed upon Nelson's termination of his employment as manager of the corporation and offer of the stock for sale to Sullivan, which offer was made.

These provisions of the memorandum agreement are clear, unambiguous, and definite. They were not affected by the parol evidence as a matter of substantive law.

The Effect on the Obligation of the Parties of the Adoption of the Corporate Resolution Dated September 10, 1948

[13] The resolution contained in the corporate minutes of September 10, 1948, has been quoted above. Since the memorandum agreement and the resolution were contemporaneously executed by Nelson and adopted by Nelson and Sullivan as directors of the corporation, they should be construed together. If the resolution and the memorandum agreement are clear, unambiguous, and consistent, there is no occasion to consider parol evidence to interpret or construe the terms of either.

[14] It is concluded that they are both clear, unambiguous, and consistent. The resolution implements the memorandum agreement by providing that the stock sold to Nelson be issued subject to the terms and conditions of the memorandum agreement restricting Nelson's right of sale. As a result of the adoption of this resolution, refer-

ence was made on the face of the stock certificates issued to Nelson in 1948 and early 1949 to the fact that the stock was not transferable except in accordance with the terms of the memorandum agreement of September 10, 1948. It is a common practice (often required by law to make the restrictions effective) to give notice of the restrictions on transfer to prospective purchasers of corporate stock.

[15] Furthermore, the ratification of Sullivan's agreement to purchase did not relieve him of the obligation to purchase Nelson's stock, or of the tax in question. In Woodworth v. Commissioner of Internal Revenue (C.A.6) 218 F.2d 719, the ratification by corporate resolution was considered and held not to relieve the taxpayers of obligation in an analogous situation.

Therefore the extrinsic parol and documentary evidence offered by the plaintiff has been received in evidence and considered as to its effect. Since this was a trial without a jury, the usual rulings on objections to evidence were not made when the evidence was offered.

[16, 17] Plaintiffs next contend that the result reached in this case is one which exalts form over substance. In the case of clear, unambiguous, valid contracts, the substantive rights of the parties are fixed by the clear meaning of the language used. In this highly technical field of federal income taxation, the clear wording of written contracts (form of transactions) fixing substantive rights must be given effect unless the wording used (form) is a sham or subterfuge or fraud. In this case the wording is none of these. Sometimes the wording used protects against tax liability, as in Stout v. Commissioner of Internal Revenue (C.A.4) 273 F.2d 345, wherein it is stated at page 352:

> "* * * If another transaction by which the parties might have come to substantially the same end would have resulted in tax liabilities because of the form in which it was cast, there is no reason to hold taxable a transaction cast in nontaxable form when the substantive bases of taxation are absent."

At other times the language in which a transaction is cast creates a tax liability which would not have existed if a different form had been used, as in this case. But in cases such as this, the form of the transaction creates and gives rise to the substantive rights and obligations involved on which taxability or nontaxability is decided.

[18] The fact that the redemption of Nelson's stock by the corporation could have been accomplished with tax consequences more favorable to the plaintiffs if a different agreement had been reached in 1948, does not alter the plaintiffs' tax liability. On this question the following language from Woodworth v. Commissioner of Internal Revenue (C.A.6) 218 F.2d 719, l. c. 724, is in point:

> "It is true that the syndicate members could have achieved their objective, yet completely avoided the tax liability here imposed, simply by their purchase of the two hundred shares owned by the minority shareholders, followed by Buckeye's redemption of all Mrs. Derby's stock. We can assume that if the transaction had been cast in that form neither petitioners nor Mrs. Derby would have been charged with the receipt of ordinary income. Cf. Zenz v. Quinlivan, 6 Cir., 1954, 213 F.2d 914.
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> "That being so, it can be argued that to permit the decision of the Tax Court to stand is to permit form to triumph over substance. Yet, to the extent here implied, it is form which often must prevail, when the delicate question involved is whether the extraction of a corporation's earned surplus has been accomplished at less than the rates taxed upon ordinary income. Cf.

> Chamberlin v. Commissioner [of Internal Revenue], 6 Cir., 1953, 207 F.2d 462. 'If a taxpayer has two legal methods by which he may attain a desired result, the method pursued is determinative for tax purposes without regard to the fact that different tax results would have attached if the alternative procedure had been followed.' Woodruff v. Commissioner [of Internal Revenue], 5 Cir., 1942, 131 F.2d 429, 430. Indeed the statute directs that the 'manner' of the transaction be a controlling factor."

[19] The evidence extrinsic of the written agreement and corporate minutes might have the effect of establishing that the corporation was secondarily liable as a guarantor or indemnitor of Sullivan's obligation to purchase Nelson's stock. But this would not alter Sullivan's tax liability if Sullivan was, as found herein to be, unconditionally and primarily obligated to purchase Nelson's stock. Compare Lowenthal v. Commissioner of Internal Revenue (C.A.7) 169 F.2d 694; Sachs v. Commissioner of Internal Revenue (C.A.8) 277 F.2d 879.

In reaching the conclusions stated herein, full credit has been given to the testimony of the distinguished lawyer Samuel L. Trusty, Esquire, as a sincere and credible recollection of events which transpired nearly twenty years ago.

DISCUSSION OF POST-DECISIONAL ARGUMENTS OF PLAINTIFFS

Until the time that the decision in this case was formally announced, both parties agreed that the only issue in the case was whether "the corporation's redemption of Nelson's stock satisfied or relieved Sullivan of an obligation to do so." Since the decision was announced and before the completion of this Memorandum, plaintiffs' counsel have, without leave of Court, filed numerous letter

briefs attempting to inject new issues in this case and new theories of non-liability of the plaintiffs for the taxes in issue. In plaintiffs' trial brief filed in this cause the day before the hearing of evidence and affirmed at the opening of the evidentiary hearing (Tr. 3), the plaintiffs' position in this case was stated as follows:

"QUESTION PRESENTED

"Whether the payment by the Sullivan-Nelson Chevrolet Company (now named Kaw Finance Company), an Arkansas corporation, of $198,334.58 on or about May 1, 1956, to Frank W. Nelson, in redemption of all of his stock in that corporation (a total of 114 shares of common capital stock), was essentially equivalent to the distribution of a taxable dividend to William J. Sullivan, a remaining stockholder of the corporation."

After stating their version of the facts in their trial brief, plaintiffs defined the critical issue in the case in the following language:

"Upon the foregoing facts the District Director, through his agent, has concluded that the corporation's redemption of Nelson's stock, by payment of the amount of $198,334.58 to Nelson, constituted the equivalent of a dividend from the corporation to Sullivan. The rationale of the Government's case is that the corporation, by the redemption, satisfied a personal obligation of Sullivan's to redeem Nelson's stock; so that the amount paid by the corporation to Nelson constituted a constructive dividend to Sullivan. To support this conclusion the Government relies upon the principle that 'payment of a taxpayer's indebtedness by a third party pursuant to an agreement between them is income to the taxpayer * * *.' Wall v. U. S., 164 F.2d 462, 464 (CA 4th 1947). See generally Mertens (Zimet Ed.), Vol. I, Sec. 9.08, page 20. With this principle the plaintiffs have no quarrel. The ques-

tion presented is whether the facts of this case invoke that principle. Generally, of course, the question of whether a corporate distribution was essentially equivalent to a taxable dividend is a question of fact and raises no question of law susceptible of review. United States v. Carey, 289 F.2d 531, 537 (CA 8th 1961); Ferro v. Commissioner [of Internal Revenue], 242 F.2d 838, 840 (CA 3rd 1957); Keefe v. Cote, 213 F.2d 651, 656 (CA 1st 1954); Woodworth v. Commissioner [of Internal Revenue], 218 F.2d 719, 727 (CA 6th, 1955); Randolph v. Commissioner [of Internal Revenue], (CA 8th) 76 F.2d 472, 476, cert. den.; Helvering v. Randolph, 296 U.S. 599 [56 S. Ct. 116, 80 L. Ed. 425] (1935). More specifically, the precise factual question presented is whether the corporation's redemption of Nelson's stock satisfied or relieved Sullivan of an obligation to do so. Resolution of this question turns on the issue of whether the corporation or Sullivan was obligated to redeem Nelson's stock. The evidence herein will establish that Sullivan was never obligated to redeem Nelson's stock; but, conversely, the corporation, from the beginning, was so obligated."

Now that what was once agreed to be the critical issue in the case has been decided in favor of the defendant, the plaintiffs have undertaken to inject numerous issues and theories into this case, and also to reargue the principal issue in different forms. These new arguments will be discussed briefly.

[20] It is argued that the defendant, and therefore the Court in this decision, did not give appropriate weight to the question of whether a *bona fide* corporate business purpose existed, in accordance with the rulings in Idol v. Commissioner of Internal Revenue (C.A.8) 319 F.2d 647; United States v. Carey (C.A.8) 289 F.2d 531, l.c. 537; Heman v. Commissioner of Internal Revenue (C.A.8) 283 F.2d 227, l.c. 231; Princess Coals, Inc. v. United States (S.D.W.Va.) 239 F. Supp. 401, and similar cases. In this

case, the only possible application of the business purpose doctrine would result from the presence of a business purpose rather than a tax avoidance purpose in causing the corporation to purchase Nelson's stock in 1956. There was no such business purpose. The only purpose apparent from this record (provided the original contract has been properly construed) was to minimize plaintiffs' income taxes by using accumulated corporate profits to discharge the primary liability of the plaintiff Sullivan without distributing the earnings as dividends to Sullivan. This is not a case where there was a novation or new arrangement resulting in a non-taxable transaction unless the novation or new arrangement were a fraud, sham, or a subterfuge. In such a case the business purpose doctrine might be decisive. Princess Coals, Inc. v. United States, supra. Full consideration and effect have been given to the business purpose doctrine in reaching the decision in this case.

[21] Plaintiffs further argue that the cases of Idol v. Commissioner of Internal Revenue, supra, and Sachs v. Commissioner of Internal Revenue, supra, and similar cases, require an economic benefit to the plaintiffs in addition to the discharge of their obligation to purchase Nelson's stock. Full consideration has been given to this argument which is deemed to be unsound. In the Sachs case, the argument of lack of economic benefit accruing to the taxpayer was disposed of by the Court briefly with this statement: "* * * we need only observe that he personally was liable for payment of the fine assessed against him for his criminal act; that it was in the nature of any other private debt, and his property and assets were liable for seizure and sale in satisfaction of such debt." The economic benefit to the plaintiff Sullivan in this case was the discharge by the corporation, with the use of undistributed corporate earnings, of his private obligation to purchase

Nelson's stock. There is nothing in the Idol case or other cases cited by the plaintiff contrary to this conclusion. Full consideration and effect have been given to the economic benefit doctrine.

Plaintiffs claim further that the transaction in question should not be treated as a constructive dividend to the shareholder because of the provisions of Section 302 of the Internal Revenue Code quoted above read in connection with Section 346. In connection with this argument, plaintiffs rely upon United States v. Carey (C.A.8) 289 F.2d 531, asserting that the regulations under Section 302, namely Reg. Sec. 1.302-3(a) (3) is in conflict with the Carey case. It is not necessary in this case to determine the soundness of this claim of conflict with the Carey case and the regulations cited. In the Carey case there was no obligation on the part of the taxpayer to purchase the stock of another shareholder which was discharged by the corporation out of earnings, as appears in this case. This is a vital distinction between this case and the Carey case.

[22] Furthermore, Section 302(a) and (b) cannot be held to exonerate the plaintiffs in this case from liability for a constructive dividend because that section applies only if the "redemption is not essentially equivalent to a dividend." Section 302(b) (1). The plaintiffs make the contention that Section 302 was intended to create a series of exceptions to the doctrine of the Holsey, Wall, Woodworth line of cases, supra, if the transaction meets the tests of any of paragraphs (2), (3), or (4) of Section 302(b) as well as if it meets the tests of paragraph (1) discussed above. This argument leads plaintiffs into a discussion of Section 346 as well.

If Section 302, alone or with Section 346, were intended to permit satisfaction of the shareholders' liability out of earnings without treating the transaction as a constructive

dividend, the statutes themselves and legislative history should make this clear, which they do not. In the Carey case, the Court not only relied upon and reaffirmed the test of the Holsey case, but explicitly stated that the meaning of "essentially equivalent to a dividend", as interpreted by the Courts in cases arising under the 1939 Code, was retained. 289 F.2d at pages 536 and 537. The taxpayers seized upon the italicized portion of the following sentence from the Carey case as rendering the doctrine of the Holsey and similar cases inapplicable:

> "It clearly appears from the Senate Report, supra, that Congress at the time it enacted the Internal Revenue Code of 1954 was familiar with the interpretation given the dividend-equivalent language by the courts, and it appears from the legislative history as a whole that Congress had no intention to change the meaning of 'essentially equivalent to dividend' as interpreted by the courts in cases arising under the 1939 Code, *in a situation such as here presented, where the facts do not fall within any of the specific new provisions* contained in §§ 302(b) or 346." (289 F.2d 536, 537. Emphasis supplied.)

[23] The fallacy of taxpayers' reasoning lies in the fact that the new provisions contained in Section 302(b) and Section 346 were never intended to apply to a situation such as this, where the corporation discharged a primary unconditional obligation of the taxpayer from its earnings. This seems to be a fair conclusion from the reading of the statute and the legislative history. Other arguments made by the plaintiffs of a similar nature are concluded adversely to the plaintiffs by the authorities and reasoning set forth above.

JUDGMENT

For the reasons given, it is hereby

Ordered and adjudged that plaintiffs' Complaint and Claim for Refund be, and it is hereby, dismissed with prejudice at the cost of the plaintiffs.

APPENDIX C

UNITED STATES DISTRICT COURT WESTERN DISTRICT OF MISSOURI

Judgment

For the reasons given, it is hereby

ORDERED AND ADJUDGED that plaintiffs' Complaint and Claim for Refund be, and it is hereby, dismissed with prejudice at the cost of the plaintiffs.

William H. Becker
District Judge

Kansas City, Missouri
June 17, 1965

(Judgment)

UNITED STATES COURT OF APPEALS
FOR THE EIGHTH CIRCUIT.

No. 18,147. September Term, 1965

William J. Sullivan and George K. Sullivan, Appellants, vs. United States of America.	Appeal from the United States District Court for the Western District of Missouri.

This cause came on to be heard on the record from the United States District Court for the Western District of Missouri, and was argued by counsel.

On Consideration Whereof, It is now here Ordered and Adjudged by this Court that the Judgment of the said District Court. in this cause, be, and the same is hereby, affirmed

August 3, 1966.

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In the Supreme Court of the United States

OCTOBER TERM, 1966

No. 768

WILLIAM J. SULLIVAN AND GEORGIA K. SULLIVAN,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

In February 1948, petitioner owned all the stock of a corporation which was in the automobile and financing business. At that time the corporation hired Nelson as manager and petitioner contracted to sell Nelson up to 40 percent of the corporation's stock. Nelson actually purchased 114 shares or 38 percent of the stock. The written contract between petitioner and Nelson provided (1) that petitioner would repurchase Nelson's stock at book value whenever Nelson so requested, and (2) that Nelson would resell the stock to petitioner at book value when he left the corporation's employ. In 1956 Nelson decided to go

into business for himself, and, pursuant to the terms of the 1948 contract, he requested petitioner to repurchase the corporation's stock from him at book value, which was then approximately $198,000. Petitioner thereupon informed Nelson that the corporation would acquire the stock from him at the contract price, and the corporation did so. (Pet. A20–A33.)

The Commissioner asserted a deficiency against petitioner on the ground that he was unconditionally obligated to purchase Nelson's stock for $198,000 so that when the corporation relieved him of this personal obligation by paying $198,000 out of corporate earnings, petitioner received a dividend of this amount. The district court upheld the government's position. It held (1) that Nelson's 1956 request that petitioner repurchase the 114 shares created "an unconditional primary obligation" on Sullivan to pay Nelson $198,000 for the stock (Pet. A39; see also Pet. A36, A42), (2) that there was "no * * * business purpose" for "causing the corporation [rather than petitioner] to purchase Nelson's stock" (Pet. A48), (3) that the "only purpose apparent from the record" for "using [$198,000 of] accumulated corporate profits to discharge the [petitioner's] primary liability" "was to minimize [petitioner's] income taxes" (Pet. A48), and (4) that petitioner realized an "economic benefit" from "the discharge by the corporation, with the use of undistributed corporate earnings, of his private obligation to purchase Nelson's stock" (Pet. A48–A49). The court of appeals affirmed, stating that there was "no corporate business purpose" for shifting the obligation to the corporation and that the

corporation's action in using $198,000 of accumulated corporate earnings to relieve petitioner "of his personal obligation" was thus "the equivalent of a dividend" (363 F. 2d 724, 729).

1. The decisions below are correct. Petitioner was primarily and unconditionally obligated to pay Nelson $198,000 for 114 shares of the corporation's stock. If petitioner had performed his contract obligation, he would have been out of pocket $198,000 cash and would have owned 100 percent of the corporation's stock. By directing his corporation to perform the contract in his place, petitioner ended up with $198,000 more cash in his pocket than if he had performed, and he still owned 100 percent of the stock.

Petitioner points out that although he saved $198,000 by causing the corporation to perform his obligation, the corporation was worth $198,000 less than it would have been if petitioner had paid Nelson the purchase price, and thus that his net worth was not really affected by whether he or the corporation paid the $198,000. This is not, however, relevant to the question whether a shareholder has received a dividend. If a corporation paid its sole shareholder a $198,000 cash dividend, the value of the corporation's stock would drop in value by $198,000 at the same time that the shareholder's personal cash increased by the same amount. Although the shareholder's net worth would not increase at all, he would be taxed on a $198,000 dividend. This is because a dividend results when corporate assets are removed from the corporation and either paid to the shareholder or used to discharge his personal obligation,

i.e., when his net worth *apart from his stock in the corporation* increases.[1]

In the instant case the corporation paid $198,000 in discharge of petitioner's personal obligation. Thus, his net worth *apart from his stock in the corporation* increased by $198,000 because of the corporate payment, just at it would have if petitioner, after paying Nelson the $198,000, had later caused the corporation to distribute a dividend of $198,000 to reimburse him. This is what the lower courts meant when they concluded that the "transaction * * * resulted in an economic benefit to [petitioner] * * * because he was relieved of his personal obligation to purchase Nelson's stock" (363 F. 2d at 729; see also Pet. A48–A49).

Petitioner also argues that the instant transaction is different than a $198,000 dividend because petitioner divested himself of and the corporation acquired both the benefits and the burdens of the contract, *i.e.*, both the obligation to pay $198,000 and the right to receive 114 shares of stock. Petitioner, however, owned all the stock of the corporation (186 shares) other than Nelson's 114 shares. Therefore, regardless of whether petitioner or the corporation purchased Nelson's 114 shares, it is clear that after the purchase was completed petitioner would own 100

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[1] See, *e.g.*, *American Properties, Inc.* v. *Commissioner*, 28 T.C. 1100, affirmed *per curiam*, 262 F. 2d 150 (C.A. 9); *Greenspon* v. *Commissioner*, 229 F. 2d 947 (C.A. 8); *Sachs* v. *Commissioner*, 277 F. 2d 879 (C.A. 8); *Jaeger Motor Car Company* v. *Commissioner*, 284 F. 2d 127 (C.A. 7); *Challenge Mfg. Co.* v. *Commissioner*, 37 T.C. 650; Bittker and Eustice, *Federal Income Taxation of Corporations and Shareholders* (1966 ed.), pp. 165–173, 294–300. Cf. *Old Colony Trust Co.* v. *Commissioner*, 279 U.S. 716.

percent of the outstanding stock of the corporation. In such circumstances, it could make no difference to petitioner whether his 100 percent ownership was represented by 186 shares or 300 shares.[2] Thus, there is no substance to petitioner's argument that he gave up something of value when he directed the corporation to acquire Nelson's 114 shares and that the corporation gained something of value when it acquired the stock. The only consequence of substance which followed from the assignment to the corporation of the contract "benefits" and "burdens" was that accumulated corporate earnings were used to discharge petitioner's $198,000 obligations to Nelson.

Petitioner argues that the instant decision is in conflict with *Commissioner* v. *Decker*, 286 F. 2d 427 (C.A. 6), affirming *per curiam* 32 T.C. 326. In *Decker*, five individuals, who owned all the stock of a corporation, had agreed that upon the death of a stockholder the survivors would buy his stock at book value. Two of the stockholders died, thus obligating the remaining three stockholders (the taxpayers) to purchase their stock. Because the corporation was "desirous of acquiring treasury stock that could be sold to key em-

[2] In somewhat similar circumstances the courts have long refused to cause tax significance to turn on the absence or presence of a transfer of stock between a corporation and its shareholders, since such a transfer would be no more than "a meaningless gesture." See *Davant* v. *Commissioner*, 366 F. 2d 874, 887 (C.A. 5), certiorari denied April 24, 1967, No. 911, this Term; see also, *e.g.*, *Liddon* v. *Commissioner*, 230 F. 2d 304 (C.A. 6), certiorari denied, 352 U.S. 824; *Commissioner* v. *Morgan*, 288 F. 2d 676 (C.A. 3), certiorari denied, 368 U.S. 836; *Heller* v. *Commissioner*, 2 T.C. 371, affirmed, 147 F. 2d 376 (C.A. 9), certiorari denied, 325 U.S. 868.

ployees" (32 T.C. at 331), it, rather than the taxpayers, purchased the stock of the two deceased stockholders.* The Commissioner argued there, as he did here, that the corporation, by discharging the stockholders' personal obligations, had paid a dividend to them. The Tax Court rejected this argument, stressing its finding that "there was a sound business reason for the corporation to acquire the stock," because the corporation needed the stock to satisfy certain of its employees who had taken "the initiative in seeking to obtain some of the stock of the company" (32 T.C. at 333). The Sixth Circuit affirmed *per curiam* (286 F. 2d 427).

In the instant case, on the other hand, both lower courts concluded that there was "no corporate business purpose" for causing petitioner's obligation to Nelson to be satisfied out of accumulated corporate earnings (363 F. 2d 729; Pet. A48), but that this route was used "to minimize [petitioner's] income taxes" (Pet. A48). Similarly, in *Schalk Chemical Co.* v. *Commissioner*, 304 F. 2d 48 (C.A. 9), where two stockholders contracted to buy out a third and then had their corporation perform the contract, the Ninth Circuit upheld the Commissioner's imposition of dividend treatment on the two shareholders whose obligations were satisfied by their corporation, distinguishing *Decker* on the ground that there "the corporate payments were for the benefit of the cor-

*In form, the taxpayers purchased the stock from the two deceased shareholders and sold it to the corporation, but the court found that they acted as agents of the corporation in carrying out the purchase.

poration and not the stockholders; here the finding is just the opposite—it was the shareholders not the corporation that derived the benefit of those payments" (304 F. 2d at 52–53).

The Commissioner does not agree with this distinction, but rather believes that whenever a shareholder, who is primarily obligated to purchase the stock of a retiring shareholder, causes his corporation to satisfy his obligation by redeeming the shares, the continuing shareholder receives a dividend.[4] There is no direct conflict among the circuits, however. For the Sixth Circuit rejected the Commissioner's position in *Decker* where "there was a sound business reason for the corporation to acquire the stock" (32 T.C. at 333), and the Eighth and Ninth Circuits upheld the Commissioner's position in the instant case and *Schalk Chemical* where there was "no corporate business purpose" (363 F. 2d at 729) for the corporation to acquire the stock. Although the Tax Court decision in *Decker*, which was affirmed *per curiam* by the Sixth Circuit, contains some language (32 T.C. at 332–333) which is inconsistent with the results reached by the Eighth and Ninth Circuits, there is no assurance that the Sixth Circuit would have decided this case—where there is no business purpose—any differently than the Eighth Circuit did.[5]

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[4] Although the Commissioner initially acquiesced in the "result" reached in the *Decker* case (1964–2 Cum. Bull. 5), he is now reexamining his acquiescence.

[5] Contrary to petitioner's contentions, the instant decision is not in conflict with cases such as *Holsey* v. *Commissioner*, 258 F. 2d 865 (C.A. 3), and *S. K. Ames, Inc.* v. *Commissioner*, 16 B.T.A. 1020, and administrative rulings such as Rev. Rul. 58-614,

2. Next petitioner contends that although the clear language of the written contract unconditionally obligated him to purchase Nelson's stock (Pet. A39, A42; 363 F. 2d at 726–728), the district court erred in refusing to consider parol evidence that the parties to the 1948 contract never intended that petitioner would be obligated to repurchase the stock but rather that they intended the corporation to be the party so obligated (Pet. 16–22). The courts below correctly held that where (as here) the written contract is unambiguous, its clear terms fix the rights of the parties and may not be altered by parol evidence—whether the opposing litigants are the parties to the contract or the Commissioner and one of the parties to the contract (Pet. A36–A39; 363 F. 2d at 726–727). The tax consequences of the instant transaction depend upon whether petitioner was unconditionally obligated to purchase Nelson's stock on demand, and this in turn depends upon whether Nelson could have established, through litigation if necessary, that such obligation existed. Since the parol evidence rule would unquestionably have applied in any litigation between Nelson and petitioner on this question, the lower courts correctly applied it in the instant case in deciding whether petitioner was obligated to buy Nelson's stock on demand.

Contrary to petitioner's contention (Pet. 19), the trend of the more recent decisions has been to reject

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1958–2 Cum. Bull. 920, and Rev. Rul. 59–286, 1959–2 Cum. Bull. 103, in which (unlike the instant case) the taxpayer-shareholder was not unconditionally obligated to purchase the retiring shareholder's stock.

the conceptual argument which had earlier led some courts to hold that one who is not a party to a contract may not invoke the parol evidence rule. Petitioner cites decisions of, *inter alia,* the Courts of Appeals for the Second, Fifth, Eighth and Ninth Circuits (Pet. 19–20), all of which have since adopted the more modern approach. See, *e.g., Clark* v. *United States,* 341 F. 2d 691, 693 (C.A. 9); *Great American Ins. Co. N.Y.* v. *Gulf Marine Drilling No. 1,* 302 F. 2d 332, 334–335 (C.A. 5); *Commissioner* v. *Dwight's Estate,* 205 F. 2d 298 (C.A. 2). And the Eighth Circuit reached the result it did in the instant case (363 F. 2d at 727) with full awareness of its earlier decisions cited by petitioner (Pet. 19). Moreover, the leading authorities in the field of evidence have uniformly pointed out the conceptual error in the earlier cases. See IX Wifimore on *Evidence,* § 2446, pp. 149–159; 3 Corbin on *Contracts,* § 596, pp. 572, 574–576; 3 Jones on *Evidence* (2d ed.), § 1489, p. 2710; 4 Williston on *Contracts* (3d ed.), § 647.[6]

3. Finally, petitioner argues that even if he was unconditionally obligated to purchase Nelson's stock on demand so that he received a $198,000 distribution from the corporation when it performed his obliga-

[6] Nor is there any conflict (Pet. 19) with the holding of this Court in *Miller* v. *Robertson,* 266 U.S. 243. The question in that case was whether a contract for the sale of all the ore under the control of the seller covered ore under the control of the seller's subsidiary. Since the contract there in question was silent on the point, this Court looked to extrinsic evidence. Thus the case has no relevance to the instant case where petitioner argues that parol evidence should be used to contradict the clear and unambiguous provisions of the written contract.

tion, this distribution is nevertheless not taxable to him as a dividend. Petitioner argues that the distribution qualifies for capital gain treatment as a "partial liquidation" under Code § 346(b), because shortly after the corporation paid out the $198,000 for Nelson's stock, it sold one of its two businesses—the automobile dealership—for approximately $100,000 and retained the finance business. However, § 346(b) applies only where a corporation, which has conducted two businesses for more than five years, distributes to its shareholders in redemption of their stock either the assets of one of the two businesses "in kind" or "the proceeds" from the sale of one of the two businesses. S. Rep. No. 1622, 83d Cong., 2d Sess., p. 262; see also H. Rep. No. 1337, 83d Cong., 2d Sess., p. A112. Thus, § 346(b) explicitly provides that it applies only to a "distribution [which] is *attributable* to the corporation's ceasing to conduct [a trade or business], or [which] consists of the assets of a trade or business" (emphasis added). The distribution of $198,000 was, however, made before the corporation decided to sell its automobile dealership (R. 81, 103–104).[7] Therefore, it clearly was not in any way "attributable" to the sale of the dealership, and the petitioner's argument is without merit.[8]

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[7] "R." references are to the printed record in the court of appeals.

[8] The § 346(b) issue is essentially factual, there is no conflict of decisions on this point and no other reason for further review.

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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APRIL 1967.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1966.

No. 768

WILLIAM J. SULLIVAN AND
GEORGIA K. SULLIVAN,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

REPLY TO MEMORANDUM FOR RESPONDENT IN OPPOSITION TO PETITION FOR CERTIORARI

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IN THE

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OCTOBER TERM, 1966.

No. 768

WILLIAM J. SULLIVAN AND
GEORGIA K. SULLIVAN,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITIONERS' REPLY

On November 14, 1966, the Petition for a Writ of Certiorari was filed which raised the question of what constitutes income under the Sixteenth Amendment. Over five months later, the respondent filed its memorandum in opposition. This is in reply to that memorandum.

Respondent does not contend that there is no Constitutional question, nor that this case does not warrant this Court's review. Indeed, respondent has conceded that the decision of the Court below produces a conflict between the Circuits, and urges only that the decisions below are

correct. Only this Court, however, determines conflicts between the Circuits—especially those involving Constitutional questions.

1. The decisions of the Courts below that there was income are erroneous.

First, the corporation did not pay petitioner a cash dividend, consequently respondent's analysis (pp. 3, 4) is irrelevant. Secondly, the corporation did not purchase property which petitioner received, pay any personal expenses of petitioner, or relieve him of a money debt for which he had previously received property or benefit. Consequently the principles and cases relied upon by respondent (p. 4, fn. 1) are not in point. Finally, the corporation did not purchase stock which the petitioner received—here the corporation redeemed its own stock and held it as treasury stock.

Respondent contends (p. 3) that "By directing his corporation to perform the contract in his place, petitioner ended up with $198,000.00 more cash in his pocket than if he had performed, * * *". Respondent necessarily assumes that petitioner had $198,000.00 before the transaction, and after the transaction had the same $198,000.00. Obviously, then, petitioner received no income—otherwise, he would have "ended up" with more than the original $198,000.00. Assume that before the transaction petitioner had cash of zero, his sole asset being the stock in the corporation. After the transaction petitioner would still have cash of zero and still have stock worth the same amount as before (about $300,000.00),[1] because of the corporate payout to redeem Nelson's stock. Plainly, petitioner received nothing.

1. For the sake of simplicity we are rounding the figures to even thousands, i.e., the corporation was worth $500,000.00, the payout to redeem Nelson's stock was $200,000.00, and petitioner's interest in the corporation was worth $300,000.00.

Assume that, as here, petitioner did not perform the contract but that it was performed by the corporation. The corporation, worth about $500,000.00 before the redemption, paid out $200,000.00 to Nelson. Petitioner's personal cash situation is unchanged. Moreover, the value of petitioner's stock interest in the corporation before and after the transaction is unchanged, as the parties herein stipulated (R. 154). Clearly if petitioner received no additional cash and the value of his stock did not increase—he received nothing of real financial or economic value. This is the precise holding of the Tax Court in *John A. Decker*, 32 T.C. 326 (1959), aff'd 286 F.2d 427 (C.A. 6th, 1960), at page 332 of its opinion.

Whether petitioner or the corporation purchased Nelson's stock makes no real financial or economic difference to any of the three parties involved in this transaction. Obviously, Nelson's position remains the same, whether petitioner or the corporation buys his stock. If petitioner purchases Nelson's stock, his financial position remains the same—he has merely exchanged one asset (cash) for another asset (stock) worth the same amount. The stock represents a claim on the corporate assets worth $200,000.00. If petitioner never disposed of Nelson's stock, his financial position with respect thereto remains in status quo. If upon purchase of Nelson's stock (paying out $200,000.00), petitioner liquidates the corporation (receiving liquidation proceeds of $500,000.00)—his financial position is the same; he "ends up" with a net of $300,000.00.

Contrariwise, assume that petitioner did not perform the contract, but that the corporation purchased Nelson's stock. As seen hereinabove, petitioner's financial position remains as it was before the transaction. If petitioner retains his stock, all he has is the worth of that stock before the transaction (about $300,000.00). If at the moment

after the corporation purchased Nelson's stock, the petitioner liquidated the corporation, all he could receive is about $300,000.00—the value of his stock before the transaction.

As urged at pages 22-26 of the petition, the subject transaction constituted not only a stock redemption by the corporation but also a partial liquidation and contraction of the corporation under Section 346(b) of the 1954 Code. Under such circumstances there is no practical difference whether the corporation redeems the stock, or whether the petitioner purchases the stock and sells it to the corporation, at the same price he paid. *John McShain*, T.C. Memo. 1963-306, 22 T.C.M. 1611, 1616. The purchase from Nelson would provide petitioner a basis in the stock of $200,000.00, if he sells the stock to the corporation for $200,000.00—because of the partial liquidation—the sale is a capital gain transaction under Section 346(b); however, there is no capital gain, and thus no tax consequences to petitioner.

Respondent's contention (p. 4) that if petitioner received some benefit from this transaction, the corporation incurred a detriment is erroneous. The redemption by a corporation of shares of its own stock which are held as treasury stock (as here) is like the acquisition of any other asset. *Commissioner of Internal Revenue* v. *Snite*, 177 F.2d 819, 822 (C.A. 7th, 1949); *Emeloid* v. *Commissioner of Internal Revenue*, 189 F.2d 230, 234 (C.A. 3rd, 1951). Moreover, it is elementary corporate law, that a corporation's stock represents an outstanding claim by the shareholders against the net assets of the corporation. It follows, that redemption by a corporation of outstanding shares of its stock reduces the claims against the corporation's assets. Many publicly-held corporations regularly redeem shares of their own stock. If this reduced the corporations' worth their shareholders could recover against the corporation's

directors. Such an action will not lie, however, since the rights of the shareholders are unaffected. Assume that there were other shareholders in the corporation with petitioner and Nelson. The worth of their stock would not have been diminished by the transaction between petitioner, Nelson, and the corporation. As a matter of "Hornbook Law" the corporation here incurred no detriment.

Thus, if petitioner performed the contract, he is not "worse off"; nor is the corporation if it performs the contract. Accordingly, this case is unlike those cases where a corporation pays out money, e.g., payment of a shareholder's fine or traffic ticket (for which it receives nothing)—and the shareholder is benefited because he did not have to pay out money for which he would have received nothing. It follows that petitioner cannot be benefited by the corporation's performance—nor the corporation's worth diminished thereby.

Respondent erroneously contends (p. 4) that petitioner's net worth, *apart* from the worth of his stock in the corporation, must be considered to determine whether he received income. Without exception, the Courts have considered the question of the shareholder's financial worth in relationship to the reduced value of his stock in the corporation.[2] The cases cited (p. 4, fn. 1) in support of respondent's theory of fragmented net worths are not in point. First, none of the cases disclose that respondent's net worth doctrine was considered or passed upon by the Courts. Secondly, none of the cases involved a stock redemption and partial liquidation. Thirdly, each case in-

2. *Ruben* v. *Commissioner of Internal Revenue*, 97 F.2d 926, 928 (C.C.A. 8th, 1938); *John A. Decker*, supra, pp. 332, 333; *Hargleroad* v. *U. S.*, 202 F. Supp. 92, 95 (D.C. Neb., 1962); *William Green*, T.C. Memo. 1963-248, 22 T.C.M. 1241, 1247 (1963); *John McShain*, supra, p. 1616; *Dwight Gahm*, T.C. Memo. 1964-118, 23 T.C.M. 665, 670; *William K. Edmister*, 46 T.C. 651, 662 (1966); *Frank Ciaio*, 47 T.C. 447, 458 (1967).

volved the corporation's payment of personal expenses of the shareholder, or the corporation purchased property which the shareholder received.

Respondent is concerned (p. 4) by the circumstance that petitioner owned all of the stock of the corporation after the transaction. First, from the standpoint of control, there is no practical difference between a shareholder owning 60% of the stock of a corporation and 100% thereof. Secondly, the parties stipulated that the value of petitioner's stock was the same before and after the redemption. Thirdly, the redemption by a corporation of one shareholder's stock cannot be treated as a dividened to the remaining shareholders merely because their percentage interests in the corporation are increased—indeed, to tax such an indirect benefit, is unconstitutional. *Holsey* v. *Commissioner*, 258 F.2d 865, 868 (C.A. 3rd, 1958). The Commissioner acquiesced to this precise holding in *Holsey*. Rev. Rul. 58-614, C.B. 1958-2, p. 920.

In the Petition for Certiorari, on the question of whether petitioner received income, it was contended that the conclusion of the Court below was in square conflict with *John A. Decker*, supra. The respondent filed applications for extension of time in this court wherein it was conceded that the result in this case is "apparently in conflict with *Decker* v. *Commissioner*, * * *". Now respondent seeks to distinguish *Decker* in contradiction to the position heretofore taken in pleadings filed with this Court. Moreover, the attempt to distinguish *Decker* is wholly without merit.

The sole ground for holding that petitioner received income is the conclusion of the Court below that he had an unconditional contract obligation which his corporation performed. In *Decker* the Court specifically held that the continuing shareholders had unconditional contract obliga-

tions—but that their performance by the corporation did not constitute income to the continuing shareholders. The two Circuits are in direct conflict on what constitutes "income". Thus is the Constitutional question framed.

Whether there was a corporate business purpose is not determinative of whether the continuing shareholder received income.[3] The real question is whether the shareholders received "some real financial or economic value".[4] Accordingly, on the Constitutional question, the judgment of the Court below is not only in square conflict with the Sixth Circuit in *Decker*, but also with the Third Circuit in *Schmitt* and *Holsey*, and the Ninth Circuit in *Niederkrome*.

The decisions of the lower Federal Courts are in hopeless confusion, which Congress attempted to resolve in the 1954 Code. It is evident that confusion and doubt persist. Nor is the Commissioner's view of the question marked by unswerving precision. The Sixth Circuit decided *Decker* in 1960. After a pause of four years, the Commissioner acquiesced therein in 1964 (1964-2, C.B. p. 5); and we are now advised by respondent (p. 7, fn. 4) that the Commissioner, seven years after *Decker*, is re-examining his acquiescence.

Petitioners urged (Pet., pp. 16, 17) respondent's admission on brief that the contract obligation assumed by the corporation was only conditional—not primary and un-

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3. *Daniel W. Northup* v. *United States*, 240 F.2d 304, 307 (C.A. 2nd, 1957); *Holsey* v. *Commissioner of Internal Revenue*, supra, p. 869; *Bradbury* v. *C.I.R.*, 298 F.2d 111, 117-118 (C.A. 1st, 1962); *Aloysius J. McGinty* v. *Commissioner*, 325 F.2d 820, 822 (C.A. 2nd, 1963); *Charles P. Hasbrook* v. *United States*, 343 F.2d 811, 814 (C.A. 2nd, 1965).

4. *Schmitt* v. *Commissioner*, 208 F.2d 819, 821 (C.A. 3rd, 1954); *Holsey* v. *Commissioner of Internal Revenue*, supra, p. 868; *Niederkrome* v. *Commissioner of Internal Revenue*, 266 F.2d 238, 243 (C.A. 9th, 1958).

conditional. (Undoubtedly respondent's admission was premised on the corporation's ratification and adoption of the contract *before* its execution by petitioner; and because the contract afforded petitioner an alternative method of performance—assignment to a third party.)

Respondent not only failed to respond to this allegation, but now contends that the contract allegation was unconditional. Again, it is elementary contract law that where the obligor has an alternative method of performance, the obligation is only conditional and akin to an option. Where the contract is an option or the obligation is only conditional, its performance by the corporation does not result in a dividend to the continuing shareholder.[5] If as respondent admitted, the contract obligation was only conditional, respondent's position herein results in grave injustice to petitioners. Moreover, respondent's position before this Court is erroneous as a matter of law and contrary to its published agreement with legal principles enunciated by the Courts. We do not suggest (and do not believe) that respondent's admissions in pleadings and briefs and its published rulings are not made in good faith. However, respondent's position herein is plagued with inconsistency. The resulting injustice to petitioners should be righted by respondent—or this Court. Moreover, if the Commissioner now changes his position in *Decker*, he should do so prospectively, not retrospectively.

2. We note that respondent's memorandum contains no response whatsover to petitioner's contention (pp. 16-22) that the result in this case is in conflict with the rule of substance versus form. We recognize respondent's reply on the parol evidence question which, however, is only collateral to the substance versus form principle.

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5. See case citations and commissioner's acquiescences, p. 17, Petition for Certiorari.

3. Petitioners contended (pp. 22-27) that the subject transaction constituted not only a stock redemption but also a partial liquidation under Section 346(b) of the 1954 Code. Respondent seems to suggest (p. 10) that this means the distribution qualifies for capital gain treatment. Petitioners made no such contention. Rather, petitioners urged that since the subject stock redemption also constitutes a partial liquidation under Section 346(b), the distribution is governed by Section 331. That statute, and the Commissioner's own regulations, specifically prohibit dividend treatment of any distribution falling under Section 346. Thus the determination of the Court below is erroneous as a matter of law, and is in direct conflict with Congressional Intent as reflected in Sections 346 and 331.

In opposing Section 346 treatment, respondent's sole contention is that the distribution was not attributable to the corporation's ceasing to conduct a business because the distribution was made before the corporation decided to sell its automobile dealership. This is plain error. The corporation decided to sell its automobile dealership at least as early as March 9, 1956 at a stockholder's meeting (R. 101, 102). The corporation's dealership assets were sold in April, 1956 (R. 81). The stock redemption was not consummated until May 1, 1956 (R. 109, 114).

There is no factual dispute—the only question is one of statutory construction. The failure of the Court below to decide this issue requires this Court's supervision.

The petition for certiorari should be granted by this Court.

Respectfully submitted,

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IN THE

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OCTOBER TERM, 1966.

No. 768

WILLIAM J. SULLIVAN AND
GEORGIA K. SULLIVAN,
Petitioners,

vs.

UNITED STATES OF AMERICA,
Respondent.

PETITION FOR REHEARING OF ORDER DENYING CERTIORARI

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Petitioners respectfully request that this Court grant rehearing of its order denying certiorari; and that the Court now grant certiorari, vacate the judgment below, and remand the case to the Court below so that a question which has not been passed upon may be decided.

In the District Court and in the Court of Appeals for the Eighth Circuit, petitioners contended that since the stock redemption was accompanied by a partial liquidation of the corporation, there could be no dividend to petitioner. Sections 346 (b) and 331, Internal Revenue Code of 1954. Though this question was presented to the Court below on brief and in the petitions for rehearing, the Court's opinion

contains no reference whatsoever thereto. The Court did not consider or decide this issue.

Sections 346 (b) and 331 prohibit the treatment of any payout in redemption as a dividend. (See petition for certiorari, pp. 22-26; petitioners' "reply" p. 9.)

Section 346 (b) was intended by Congress to clarify the 1939 Code by segregating the test of whether there had been a contraction or partial liquidation of the corporation from the "dividend equivalency" test. *United States* v. *Carey*, 289 F.2d 531, 536 (C.A. 8th, 1961); *Sorem* v. *C.I.R.*, 334 F.2d 275, 279-280 (C.A. 10th, 1964); *McCarthy* v. *Conley*, 341 F.2d 948, 951 (C.A. 2nd, 1965); *The Law of Federal Income Taxation* (Mertens), Vol. I (Zimet Ed.), Sec. 9.70, p. 134; *Code Commentary* (Mertens), Sec. 346, p. 178. By statute, transactions under Section 346 (b) are "not essentially equivalent to a dividend". Section 346 (b); S. Rep. No. 1622, 83rd Cong., 2nd Sess., 3 U.S. Code Cong. and Adm. News (1954), p. 4900; *United States* v. *Carey*, supra, p. 536; *McCarthy* v. *Conley*, supra, p. 955.

The Court below (opinion p. 6) relied on Sections 301 and 302 of the 1954 Code. Since the stock redemption here was accompanied by a partial liquidation under Section 346 (b)—as a matter of law—neither Section 301 nor 302 is applicable. (Where Section 346 applies, any distribution is governed by Section 331 and that Section (and the regulations) specifically provide that Section 301 is not applicable. Moreover, if a distribution falls under both Sections 302 and 346, only the latter provision is applicable. Section 346 (c); Regulations Sec. 1.346-2; *Code Commentary* (Mertens), Section 346 (c): 1, p. 183. Without Section 301 there can be no dividend.

The Court below in *United States* v. *Carey*, supra, p. 536, specifically recognized the relationship of Sections 346 and 331 to Sections 301 and 302.

The decision of the Court of Appeals is plainly erroneous since it is contrary to the statutes. If permitted to stand, the judgment of the Court below completely frustrates the intent of Congress in enacting Sections 346 and 331. Moreover, since the Court has not decided this question, petitioner has been deprived of his right of appellate review.

There is ample authority and precedent for this Court to remand a case to a Court of Appeals where a question has not been decided by that Court. 28 U.S.C., Sec. 2106; *Aetna Casualty & Surety Co.* v. *Flowers*, 330 U.S. 464, 468 (1947); *Dean Milk Co.* v. *City of Madison, Wis.*, 340 U.S. 349, 357 (1950); *Swanson* v. *Traer*, 354 U.S. 114, 117 (1957); *C.I.R.* v. *Duberstein*, 363 U.S. 278, 293 (1960); *Nolan* v. *Transocean AirLines*, 365 U.S. 293, 295 (1961); *Leonard* v. *United States*, 378 U.S. 544 (1964); *Redmond* v. *United States*, 384 U.S. 264, 265 (1966).

The present record is sufficient for consideration and decision; consequently, further hearing will not be required. The question is solely one of law and is dispositive of the case.

For the reasons set forth in this petition for rehearing, as well as in the petition for certiorari, rehearing and certiorari should now be granted, the judgment below should be vacated, and the case remanded to the Court of Appeals for the Eighth Circuit for decision on this question.

Respectfully submitted,

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CERTIFICATE OF COUNSEL

Pursuant to Rule 58, I hereby certify that the foregoing Petition for Rehearing is presented in good faith and not for delay, and is restricted to the grounds specified in paragraph 2 of Rule 58.

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